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THE MEMORIAL LECTURE SERIES — 1983

THE RECENT EROSION OF THE SECURED CREDITOR'S RIGHTS THROUGH CASES, RULES AND STATUTORY CHANGES IN BANKRUPTCY LAW

James J. White

ARTICLE

THE LAWYER AS HERO

James L. Robertson

COMMENTS

AN ANALYSIS OF THE APPLICATION OF THE CLEARLY ERRONEOUS STANDARD OF RULE 52(a) TO FINDINGS OF FACT IN FEDERAL NONJURY CASES

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THE UNIVERSITY OF MISSISSIPPI SCHOOL OF LAW MEMORIAL LECTURES

The University of Mississippi School of Law Memorial Lectures were established in 1973 by the Jackson, Mississippi, law firm of Butler, Snow, O'Mara, Stevens & Cannada. The Lectures honor the memory of the firm's founding partners, George H. Butler, Sr., Charles B. Snow, and J. Morgan Stevens; their purpose is to "provide substantial educational enrichment opportunities for the students and faculty of the Law School, and such members of the bench, bar, and academic community as may appropriately be included." To this end the Lecture series has, since 1974, brought to the Law School an array of distinguished legal scholars, each of whom through consideration of his particular area of concentration explores the general theme of the Lectures: "The Role of Law in the Remainder of the Twentieth Century." Although diverse in their areas of expertise, the Memorial lecturers are united by this theme, and by a community of superior intellect and talent. The value to the faculty and students of the Law School of our experience with these lecturers can hardly be overstated; they have informed, intellectually challenged, and inspired us.

The 1983 Lectures continue the tradition of bringing to the University of Mississippi School of Law the best minds in legal education. James J. White is recognized as perhaps the foremost authority on commercial and consumer law in the United States. Professor White received his B.A. degree, magna cum laude, from Amherst College in 1956; he received his J.D. from the University of Michigan in 1962. He is a member of Phi Beta Kappa and the Order of the Coif. Prior to beginning his teaching career Professor White practiced with the Los Angeles, California firm of Latham & Watkins. In 1964 Professor White joined the faculty of the University of Michigan, and with the exceptions of 1973 and 1975, when he served as a visiting professor at Harvard University and Wayne State University respec-

tively, he has served there in both administrative and professorial positions until the present. He served as Associate Dean of the Law School 1978-81, and currently holds the Robert A. Sullivan Professorship.

A prolific writer, Professor White has written several books and has contributed to leading law reviews. His publications are far too numerous to list here, but they include: Negotiation Materials and Problems, with Harry Edwards (1976); Commercial and Consumer Law, with Speidel and Summers (1981); and Banking Law Teaching Materials (1976). His Handbook of the Law Under the Uniform Commercial Code, co-authored with Professor Robert S. Summers of the Cornell University School of Law, is recognized as the leading treatise on our most important commercial statute.

Professor White has also put his expertise in commercial law to work outside the halls of academe. He served as Co-director of the Michigan Clinical Law Program, as Executive Director of the National Institute for Consumer Justice from 1972-74, and as Chairman of the Governor's Advisory Commission on the Regulation of Financial Institutions in 1976.

Obviously Professor White is uniquely qualified to write on his subject, the current and future status of the secured creditor's rights. It is an area that profoundly affects the way America does business, and hence one which in time touches the life of each of us. Professor White treats the topic with a thoroughness and insight that demonstrate more clearly than can be expressed his years of experience and his exceptional abilities.

Dean Parham H. Williams, Jr.
University of Mississippi
School of Law

THE RECENT EROSION OF THE SECURED CREDITOR'S RIGHTS THROUGH CASES, RULES AND STATUTORY CHANGES IN BANKRUPTCY LAW

*James J. White**

I. The Restrictions

One can view the law of creditors' rights as a series of cycles in which alternatively the rights of the creditor and then those of the debtor are in ascendancy. Looking back through American legislative history, one sees both the state legislatures and the Congress intervening on behalf of debtors in a variety of ways on many occasions. An early example of such intervention was the enactment, particularly in the Midwest and West, of generous exemption laws[1] that removed a variety of property beyond the reach of general creditors. A second example is the enactment of usury laws, which continue to be a substantial restriction on the rates that creditors can charge to consumer debtors.[2] Other ex-

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The author wishes to acknowledge the work of Teri Rasmussen, Class of 1984, University of Michigan Law School.

[1] In 1871, a Louisiana debtor could exempt as much as $18,000 worth of property and a Kansas debtor could exempt more than $6,200 worth of property. *See* P. Coleman, Debtors and Creditors, 1 N. Am. 25 (1974). *See also* Comment, *Debtor Exemption Laws and the Farmer: Suggestions for Judicial Reform*, 11 U.C.D.L. Rev. 573, 573-78 (1978) (while now often rendered obsolete by inflation and technological advances, exemption statutes were generally commensurate with the living standards at the time of their enactment).

[2] Currently, forty-seven states have general usury ceilings. Note, *Usury Legislation—Its Effects on the Economy and a Proposal for Reform*, 33 Vand. L. Rev. 199, 199 (1980). These statutes vary widely in their permissible interest rates, methods of setting rates, exceptions, allowable defenses, and sanctions. Long, *Trends in Usury Legislation—Current Interest Overdue*, 34 U. Miami L. Rev. 325, 328 (1980). For specification of the maximum legal and contract rates allowed, *see* 1 Consumer Cred. Guide (CCH) ¶

amples are laws giving mortgagors rights to redeem property after foreclosure[3] and laws providing for upset prices at foreclosure sales.[4] These legislative attempts to protect certain debtor interests often have been frustrated by the clever devices of creditors' lawyers. Thus, some of the restrictions on foreclosure and redemption periods were met by deeds of trust with explicit powers to sell.[5] Usury laws have been circumvented by the advocacy of the time-price doctrine and by the substitution of a variety of fees and charges in lieu of interest.[6] Thus, if one carefully examined the law of most states, one would find a continuous cycle of hard times, debtor complaint, legislative response, and creditor attempts at circumvention.

It is my thesis that from the election of President Johnson in 1965 until the passage of the Bankruptcy Reform Act in 1978, we have witnessed one-half of such a cycle. During that time Congress enacted eight titles of the Consumer Credit Protection Act.[7] Various parts of that Act protect debtors against certain

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[3] A statutory right of redemption after foreclosure is available in twenty-six states. Comment, *Statutory Redemption Following Power of Sale Foreclosure in Missouri*, 47 MO. L. REV. 309, 310 (1982). *See generally* A. AXELROD, C. BERGER & Q. JOHNSTONE, LAND TRANSFER AND FINANCE 139-40 (1978); G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 536-47 (1979) (generally describing the variations and effect of statutory rights of redemption).

[4] A vestige of the Great Depression, the fixing of a minimum upset price at which the land must be bid in if the sale is to be confirmed was first established judicially. *See* Suring State Bank v. Giese, 210 Wis. 489, 246 N.W. 556, 557 (1933). While somewhat limited by subsequent decisions, the underlying principle has been preserved to some extent by statute. *See generally* G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 466-71 (1979) (describing the conducting of a foreclosure sale, including the nature and purpose of an upset price).

[5] *See* J. DUKEMINIER & J. KRIER, PROPERTY 621 (1981).

[6] *See* Jordan and Warren, *A Proposed Uniform Code for Consumer Credit*, 8 B.C. INDUS. & COM. L. REV. 441, 443 (1967); Kripke, *Consumer Credit Regulations: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 452-54 (1968) (discussing the usefulness of the time-price doctrine in the growth of credit selling as a means of avoiding usury restrictions). Despite substantial criticism, the time-price doctrine remains viable. *See* R. SPEIDEL, R. SUMMERS & J. WHITE, COMMERCIAL AND CONSUMER LAW 447 (1981). *See also* Jordan & Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387, 396 (1968) (charges such as brokerage or investigation fees, while technically not interest, effectively increase the return to the lender).

[7] Electronic Fund Transfer Act, Pub. L. No. 95-630, 92 Stat. 3728 (1978); Fair Debt Collection Practices Act, Pub. L. No. 95-109, 91 Stat. 874 (1977); Consumer Leasing Act of 1976, Pub. L. No. 94-240, 90 Stat. 257 (1976); Equal Credit Opportunity Act Amend-

forms of garnishment,[8] restrict the collection activities of professional debt collectors,[9] require certain credit-price disclosures to consumer-debtors,[10] and impose a set of rules upon those that conduct consumer electronic fund transfers.[11] In the same spirit of consumer protection, the Uniform Consumer Credit Code was recommended for adoption in the various states by the National Conference of Commissioners on Uniform State Laws, first in 1968, and then in 1974 as amended to conform with the federal Truth-in-Lending Act. Designed comprehensively to regulate loan and sale credit up to $25,000 to individuals for personal, family, household, or agricultural purposes, various provisions include uniform disclosure requirements, ceilings on charges, and restrictions on contract terms and enforcement rights.[12] Some states, such as Iowa[13] and Wisconsin,[14] passed legislation even more solicitous of the consumer. Wisconsin, for instance, specifically authorized class actions for alleged violations,[15] made Truth-in-Lending Act disclosures applicable in a wider range of transactions,[16] placed additional restraints on creditor collections activity,[17] and expanded the UCCC "cooling off period" beyond credit sales consumated in the home.[18]

One can argue that the debtor portion of the cycle reached

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ments of 1976, Pub. L. No. 94-239, 90 Stat. 251 (1976); Fair Credit Billing Act, Pub. L. No. 93-495, 88 Stat. 1511 (1974); Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (1968); Fair Credit Reporting Act, Pub. L. No. 90-321, 82 Stat. 146 (1968); Equal Credit Opportunity Act, Pub. L. No. 90-321, 82 Stat. 146 (1968).

[8] Consumer Credit Protection Act § 301, 15 U.S.C. § 1671 (1976).

[9] Consumer Credit Protection Act § 801, 15 U.S.C. § 1692 (Supp. V 1981).

[10] Consumer Credit Protection Act § 101, 15 U.S.C. § 1601 (1976).

[11] Consumer Credit Protection Act § 901, 15 U.S.C. § 1693 (Supp. V 1981).

[12] Currently only ten states have adopted the Uniform Consumer Credit Code in any form. For a description of its provisions and state variations, *see* 1 CONSUMER CREDIT GUIDE (CCH) ¶ 4770.

[13] IOWA CODE § 537 (1983).

[14] For a discussion of the legislative history of the Wisconsin Consumer Act, see Davis, *Legislative Restriction of Creditor Powers and Remedies: A Case Study of the Negotiation and Drafting of the Wisconsin Consumer Act*, 72 MICH. L. REV. 1, 3 (1973).

[15] The UCCC was silent on the matter. *See* Barrett & Jones, *Wisconsin Consumer Act—A Freak Out*, 57 MARQ. L. REV. 483, 489-91 (1974).

[16] *See* Heiser, *Wisconsin Consumer Act—A Critical Analysis*, 57 MARQ. L. REV. 389, 423-28 (1974).

[17] *See* Barrett & Jones, *supra* note 15, at 498-501.

[18] *See* Heiser, *supra* note 16, at 448-49.

its apogee with the enactment of the Bankruptcy Reform Act (the Code) on November 6, 1978. The Code contained little that was directly beneficial to secured creditors' interests, and much that was damaging. It was passed over the vigorous objection of some creditors and with the reluctant cooperation of others.[19] One suspects that those who cooperated did so out of a fear that they would have fared even worse had they not presented their arguments to the Congress. The Bankruptcy Reform Act had been before the Congress in various forms since 1973.[20] It is improbable that the Code in its current form could have made it through any Congress prior to 1978 or any since the election of President Reagan.

This expansion of debtors' rights beginning in 1965 came on the heels of one of the most important codifications of creditors'

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[19] During the subcommittee hearings, some creditors strongly opposed the Bankruptcy Reform Act. *See, e.g., Hearings on HR 31 and HR 32 before the Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary,* 94th Cong., 2nd Sess. 1737 (1976) (testimony of Franklin Cole, Chairman of Walter Heller & Co.) (proposed Act will not benefit bankrupts or unsecured creditors and will injure small and medium-sized businesses by drying up an already limited source of financing); *id.* at 1824 (testimony of Eli Silberfield, general counsel for the National Commercial Finance Conference) (proposed Act increases the cost of financing and therefore makes it unavailable to small businesses).

Other creditors said that they favored the Act, but would make significant changes. *See id.* at 1776 (testimony of Martin Pinsen, representing the National Association of Small Business Investment Companies (SBICs)) (favoring the Act, but desirous of excluding SBICs from the category of affiliates since affiliates' claims are subordinate to those of other creditors); *id.* at 1666 (testimony of Richard Kaufman, National Association of Credit Management) (bill is fundamentally sound but creditors should have more control in bankruptcy proceedings and be able to select a trustee and elect a creditors' committee in rehabilitation chapter cases); *id.* at 1775 (testimony of Patrick Murphy) (Act does not sufficiently clarify the rights of secured creditors in rehabilitation proceedings).

See also Reisman, *The Challenge of the Proposed Bankruptcy Act to Accounts Receivable and Inventory Financing of Small-to-Medium-Sized Businesses,* 83 COM. L. J. 169, 211 (1978) (proposed Act creates a "minefield for the unwary creditor," encourages debtors to declare bankruptcy, and will severely diminish the flow of credit, especially to small businessmen).

[20] *See* P. MURPHY, CREDITORS' RIGHTS IN BANKRUPTCY § 1.05 (1980). For a description of the origins of the movement for comprehensive reform of the bankruptcy laws and its subsequent odyssey, see Kennedy, *Background and Overview of the Bankruptcy Code of 1978,* in THE BANKRUPTCY REFORM ACT OF 1978 2-11 (C. Holmes ed. 1979). For a discussion of specific bills introduced prior to the final bill, see 1 COLLIER ON BANKRUPTCY ¶ 1.03 (rev. 15th ed. 1983).

interests, namely, the enactment of Article 9 of the Uniform Commercial Code. In the 1950's and through the middle of the 1960's, all of the states but Louisiana enacted Article 9 of the UCC.[21] By validating provisions such as after-acquired property clauses[22] and the secured creditors' rights with respect to future advances,[23] and by granting a simple, inexpensive and precise

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[21] A tabular record of the Code's enactment in the various states can be found in 1 U.L.A. 1-2 (Supp. 1982). Thirty-two states now have adopted the 1972 revisions of Article 9. *See* Schimberg, *Secured Transactions*, 36 BUS. LAW. 1347, 1347 (1981). Unless otherwise noted, all citations to the Uniform Commercial Code (UCC) will be to the 1972 version.

[22] Article 9 permits creation of a "floating lien" in accounts receivable, inventory, proceeds or similar property other than nonaccession consumer goods acquired subsequent to the formation of the original security agreement that secures any or all obligations covered by that agreement. *See* U.C.C. §§ 9-204, -306 (1972). Although a floating lien can be subordinated to a conflicting purchase money security interest pursuant to U.C.C. § 9-312 (3)-(4) (1972), the Article 9 provisions generally recognize a broader after-acquired property interest than existed prior to the adoption of the Uniform Commercial Code. Several states refused to recognize floating liens at all, apparently in the belief that to ensure the protection of creditors a borrower should not be allowed to encumber all his assets. *See* U.C.C.]!e 9-204 comment 2 (1972). Many states required successive filings with each acquisition of property by the debtor, and others required new chattel mortgages or similar security devices as well as additional filings for each transaction if a creditor was to have effective rights even against the debtor. The secured party might also be required to exercise extensive control over his collateral to maintain his security interest; U.C.C. § 9-205 abolishes this "policing" rule. Section 9-204(1) places a security interest arising out of an after-acquired property clause on an equal footing with a security interest in collateral in which the debtor has rights at the time the security agreement is negotiated without any further action by the secured party. *See* U.C.C. § 9-204 comment 1 (1972).

[23] Although few jurisdictions went so far as to invalidate future advance agreements, a pre-Code prejudice existed against such arrangements comparable to that against after-acquired property clauses. Frequently the original security agreement was required to specify the amount and disbursement time of the advances for them to be valid. *See* U.C.C. § 9-204 comment 5 (1972). Section 9-204(3) authorizes future advances, requiring only that the obligation be one covered by the security agreement. Section 9-312(7) in general provides that the priority of a subsequent advance relates back to the original filing when in conflict with another security interest, regardless whether made pursuant to commitment.

Buyers other than in the ordinary course of business are permitted to take free of the security interest only in the rare instance when the advance is not made pursuant to a commitment entered into prior to the forty-sixth day after the purchase and either the advance is made more than forty-five days after the purchase or the secured party knows of the purchase. U.C.C. § 9-307(3) (1972). Similarly, lien creditors can subordinate future advances only if they are made more than forty-five days after the lien arises and then only if they are made with knowledge of the lien and not subject to a prior commitment made without knowledge. U.C.C. § 9-301(4) (1972). This forty-five day period corre-

method of acquiring priority,[24] Article 9 expanded and confirmed personal property secured creditors' rights.

Why the cycle reversed itself in the mid 1960's is unclear. Unlike many prior debtor cycles that were stimulated by the desperate needs of debtors in the grips of recession, this cycle commenced in a time of relative prosperity. On a superficial level one might argue that the reversal is but an additional manifestation of the anti-establishment views of the post-Vietnam era, of George McGovern, and of the left wing of the Democratic party. This is too simple, for one sees seeds of the movement with President Johnson and his "great society." History may conclude that President Johnson, like President Jackson 130 years previously, was bringing southern populism to Washing-

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sponds to the Federal Tax Lien Act of 1966 provision regarding protection of advances made after the filing of tax liens. *See* I.R.C. § 6323(c), (d) (1976). For further discussion regarding the Federal Tax Lien Act of 1966's expansion of secured creditor's rights, see *infra* note 24.

[24] U.C.C. § 9-201 (1972) grants a secured creditor, even an unperfected secured creditor, priority over an unsecured creditor without a lien. While § 9-301(1)(b) (1972) provides that an unperfected secured creditor is subordinate to the rights of a lien creditor, by negative implication a prudent secured creditor can avoid the problem simply by perfecting his security interest pursuant to the instructions specified in § 9-303 (1972). Priority among conflicting nonpurchase money security interests in the same collateral is given to the first perfected or filed, whichever is earlier, so long as there is no period thereafter in which there is neither filing nor perfection. U.C.C. § 9-312(5) (1972). Other rules of priority governing particular sorts of conflicting security interests are provided in other subsections of § 9-312 as well as in § 9-313 (fixtures), § 9-314 (accessions), § 9-315 (commingled goods), and § 9-306 (proceeds).

A trustee in bankruptcy has the rights of a lien creditor and is treated so under the Uniform Commercial Code. 11 U.S.C. § 544(a) (1976); U.C.C. § 9-301(3) (1972). Thus a prudent secured creditor can easily gain priority over the trustee in bankruptcy by perfecting his security interest.

A prudent secured creditor also can maintain his priority over federal tax liens provided he checks the files every forty-five days. If the security interest is perfected before the tax lien is filed, the secured party wins even if he had actual knowledge of the tax lien. I.R.C. § 6323(a) (1976). Even after notice of the tax lien is filed, the secured creditor can make disbursements before the forty-sixth day following the tax lien filing date if he has no actual knowledge of the tax lien. I.R.C. § 6323(d) (1976). The secured creditor also can reach after-acquired property obtained by the debtor-taxpayer within forty-five days following the tax lien filing date. I.R.C. § 6323(c) (1976). Article 9 has sought to preserve this priority in its rules governing conflicts between lien creditors and secured creditors.

This is a significant change from the law prior to 1966, which made any disbursement after the tax lien was filed subordinate to the tax lien. *See* W. PLUMB, FEDERAL TAX LIENS 88 (3d ed. 1972).

ton. By the late 1960's, it seems likely that there was a confluence of all the wings of the Democratic party, from the southerners who were conservative in many respects but populists in matters of money, to the northern liberals and even radicals to whom private property was suspect. The force was so strong that even President Nixon, who hardly could have been sympathetic to the movement, supported the establishment of the National Institute for Consumer Justice.[25] Almost annually the Congress added to the Consumer Credit Protection Act, and encroached further on traditional state creditors'-rights law.[26] Here too, the Federal Trade Commission was emboldened to tread on the most sacred principle of all and effectively to abolish the holder in due course doctrine by its rule promulgated in 1975.[27]

Against the background of such enactments that were overtly and intentionally contrary to creditor interests, the

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[25] The National Institute for Consumer Justice, inspired by a February 1971 presidential address calling upon "interested private citizens to undertake a thorough study of the adequacy of existing procedures for the resolution of disputes arising out of consumer transactions," was organized as a non-profit corporation in the District of Columbia in the summer of 1971. During its two-year tenure, the Institute's work focused on the problems facing consumers who suffered economic loss by paying for defective or misrepresented goods or services. *See* REDRESS OF CONSUMER GRIEVANCES, THE NATIONAL INSTITUTE FOR CONSUMER JUSTICE xi-xii (1973).

[26] *See supra* note 7. Section 123 of the Fair Credit Reporting Act of 1968, Pub. L. No. 90-321, 82 Stat. 152 (codified at 15 U.S.C. § 1633 (1970)), allowed the Federal Reserve Board to "exempt from the requirements of this part [15 U.S.C. §§ 1631-65 (1970)] any class of credit transactions within any State if it determines that under the law of that State that class of transactions is subject to requirements substantially similar to those imposed under this part, and that there is adequate provision for enforcement," thereby applying pressure on the states to revise their consumer credit laws. For a treatise extensively dealing with the evolution of state legislative regulation of consumer credit (traditional state creditors'-rights law), see B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965).

[27] 16 C.F.R. § 433 (1982). The holder in due course doctrine was one of the principal devices relied upon by finance companies to assure payment by a consumer despite consumer dissatisfaction with a purchase. Under this longstanding doctrine, a seller's negotiation of a purchaser's note to a third party qualifying as a holder in due course generally prevented the purchaser from asserting any defenses to nonpayment. The FTC's rule effectively abolished the doctrine in most consumer credit transactions. *See* Benson & Squillante, *The Role of the Holder in Due Course Doctrine in Consumer Credit Transactions*, 26 HASTINGS L.J. 427, 440-42 (1974); Randolph & Whitman, *The Last Nail in the Coffin of the Holder in Due Course Doctrine*, 14 AM. BUS. L.J. 311, 311-12, 327-31 (1977).

Bankruptcy Reform Act must have seemed innocuous. The Code was a significant, though not radical, departure from that proposed by a respected Commission.[28] To the extent that it has proved to be contrary to the interests of secured creditors, it has been so not because a specific lobbying group set out to attack secured creditors. Rather, the most serious injury to creditor interest probably will come through a combination of and a relatively subtle interaction among various parts of the Code. Nevertheless, it seems unlikely that the Code could be passed today, or that it could have been passed at any time prior to 1978.

Against that short history consider my thesis. First, I maintain that a series of changes in the law since 1965 have substantially reduced the personal property secured creditors' rights. Second, I argue that we are about to enter upon the second part of the historic cycle in which clever creditor lawyers devise novel ways of doing business, and creditors adopt new practices to minimize the impact of the law's change. Because we are not yet deeply into this phase, I necessarily will be guessing, not only about some of the consequences of the new law, but about the creditors' response to them.

Specifically, I will address six recent changes, some in the bankruptcy rules, some through the Code, and one through case law, that have diminished the rights of secured creditors. The first is the operation of the automatic stay. Second is the debtor's right to use and sell the creditors' collateral provided only that he gives adequate protection. Third is the debtor's capacity to impose a plan or reorganization on an unconsenting secured creditor in Chapter 13 or 11. Fourth are the expanded avoidance powers. Fifth is the expansion of the jurisdiction and reach of the bankruptcy court, and finally are the recent cases

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[28] The Commission on the Bankruptcy Laws of the United States was created by Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (1970). For a brief discussion of its origins and findings, see Kennedy, *Background and Overview of the Bankruptcy Code of 1978*, in THE BANKRUPTCY REFORM ACT OF 1978 3-8 (C. Holmes ed. 1979); Kennedy, *Foreward*, 21 U.C.L.A. L. REV. 381, 381-87 (1973).

Although the Bankruptcy Code as passed does not bear any strong resemblance to the Commission's draft, many of the Commission's suggestions were preserved. *See* P. MURPHY, CREDITORS' RIGHTS IN BANKRUPTCY § 1.05 (1980). *See generally*, Kennedy, *Background and Overview of the Bankruptcy Code of 1978*, in THE BANKRUPTCY REFORM ACT OF 1978 3-7 (C. Holmes ed. 1979).

that apply fraudulent conveyance law to foreclosure sales. In the second portion of the article I will identify six ways in which secured creditors may be expected to respond to these events.

A. The Automatic Stay

Prior to the last decade, no comprehensive automatic stay applied to secured creditors' collection activities upon the filing of a bankruptcy petition.[29] The burden was upon the debtor in possession or the trustee to prove his basis for a restraining order and to convince the court to grant him one.[30] While the courts clearly had jurisdiction to restrain creditor activity upon the filing of any petition in bankruptcy,[31] in practice it appears

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[29] *See* Martin, *Creditor Alternatives to Obtain Relief from Automatic Stays in Bankruptcy*, 87 COM. L.J. 22, 23 (1982). No automatic stay of any kind operated in liquidation proceedings and only some Chapter proceedings provided for even limited automatic stays. *See* 2 COLLIER ON BANKRUPTCY ¶ 362.01(2) (rev. 15th ed. 1983). The filing of a bankruptcy petition triggered an automatic stay only in Chapter XII and even then was effective only against in rem actions. Bankruptcy Act of 1898, § 428, 11 U.S.C. § 828 (1970) (repealed 1978). An automatic stay also existed in Chapter X proceedings, but did not become effective until the petition was approved — an event that might occur immediately in a voluntary case but could take much longer. Bankruptcy Act of 1898, §§ 141, 148, 11 U.S.C. §§ 541, 548 (1970) (repealed 1978). Even these limited automatic stays were of dubious importance because the petitions filed under these Chapters accounted for a very small portion of all bankruptcy petitions filed. *See* BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1981 § 539 (102d ed. 1981). Discretionary stays were permitted at various stages of the proceedings in bankruptcy actions other than straight bankruptcy. *See, e.g.*, Bankruptcy Act of 1898, §§ 77(j), 83(c), 113, 116(4), 314, 614, 11 U.S.C. §§ 205(j), 403(c), 513, 516(4), 714, 1016 (1970) (repealed 1978).

[30] 2 COLLIER ON BANKRUPTCY ¶ 362.01(2) (rev. 15th ed. 1982). The promulgation of the Rules of Bankruptcy Procedure in the early seventies shifted the burden to the creditor by imposing an automatic stay operative upon the filing of a debtor's petition for relief under various Chapters, including the most commonly used form of debtor rehabilitation — Chapter XI. *See* 11 U.S.C. Bankr. R. 401, 601, 8-501, 9-4, 10-601, 11-44, 12-43, 13-401 (Supp. V 1975) (repealed 1978); BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1981 § 539 (102d ed. 1981). Creditors rather than debtors thereafter were obliged to go to court for appropriate relief. *See* Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. MICH. J. L. REF. 3, 4 (1978).

[31] *See* Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J. L. REF. 177, 190-91 (1978); Murphy, *Restraint and Reimbursement: The Secured Creditor in Reorganization and Arrangement Proceedings*, 30 BUS. LAW. 15, 18 (1974); Peitzman & Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings*, 65 CALIF. L. REV. 1216, 1219-23 (1977). In addition to general injunctive powers to restrain creditors, the Bankruptcy Act explicitly made several provisions for issuance of stays at the discretion of the court. *See, e.g.*, Bankruptcy Act of 1898, §§ 77(j), 83(c), 113, 116(4), 314, 614, 11 U.S.C. §§ 205(j), 403(c), 513, 516(4), 714,

that the presence of injunction power was far less threatening to a secured creditor than an automatic stay that bears similar contempt powers.[32] Because the stay was not automatic, different standards were applied by different courts in determining whether the debtor or trustee had carried his burden.[33] Whether to grant such an order rested with the discretion of the bankruptcy judge, and one can safely conclude that many debtors did not receive restraining orders in circumstances where the automatic stay would have applied. Perhaps an even larger number of creditor activities were not stayed because the debtor or trustee failed to ask for a stay.[34]

Between 1973 and 1976, the Rules of Bankruptcy Procedure incorporated automatic stays throughout the various types of proceedings similar to the single one now found in section 362 of the Code.[35] Because Chapter XI was the most widely used business reorganization provision and because it provided for no stay whatsoever before the enactment of Rule 11-44, enactment of that rule was by far the most important.

In theory, and occasionally in fact, the presence of the stay does not diminish the amount a secured creditor will receive out of the bankrupt estate.[36] If the value of the collateral exceeds

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1016 (1970) (repealed 1978).

[32] *See* 2 COLLIER ON BANKRUPTCY ¶¶ 362.01-.03 (rev. 15th ed. 1983).

[33] *See* P. MURPHY, CREDITORS' RIGHTS IN BANKRUPTCY § 6.14 (1980); Kennedy, *The Automatic Stay in Bankruptcy,* 11 U. MICH. J. L. REF. 177, 238-39 (1978).

[34] Several commentators, however, have speculated that seeking a blanket stay at the outset of bankruptcy proceedings, especially Chapter proceedings, was a very widespread practice and that a stay in one form or another was frequently granted. *See* 2 COLLIER ON BANKRUPTCY ¶ 362.01(2) (rev. 15th ed. 1983); Kennedy, *The Automatic Stay in Bankruptcy,* 11 U. MICH. J. L. REF. 177, 190 n.78 (1978).

[35] *See supra* note 7. In contrast to the Bankruptcy Act, the automatic stays provided by both the Rules of Bankruptcy Procedure and section 362 of the Bankruptcy Code immediately arise upon the filing of a petition regardless whether the petition was voluntary or involuntary; the Chapter XII automatic stay could arise only in voluntary cases. While the stay against liens in straight bankruptcy cases was less comprehensive than that applicable in debtor rehabilitation cases under the Rules of Bankruptcy Procedure, section 362 applies equally to all bankruptcy proceedings. *See* Kennedy, *Automatic Stays Under the New Bankruptcy Law,* 12 U. MICH. J. L. REF. 3, 4-5 (1978); Kennedy, *The Automatic Stay in Bankruptcy,* 11 U. MICH. J. L. REF. 177, 177 (1978).

[36] *See* H.R. REP. No. 595, 95th Cong., 1st Sess. 340-44, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6296-301. S. REP. No. 989, 95th Cong., 2d Sess. 49-51, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5835-37. *See also* Banker's Life Ins. Co. v.

the debt upon the filing of the petition by an amount greater than the interest that the creditor would have collected during the pendency of the bankruptcy proceeding, section 506(b) of the Code will allow the creditor to receive that interest together with his collateral or its value.

In many cases the stay, together with the principle that an undercollateralized creditor does not receive interest pending the outcome of the bankruptcy, will mean that the secured creditor will ultimately receive less than he would have had his collateral been handed over to him on the date the petition was filed. Assume, for example, that the prime interest rate is 15%, that our hypothetical creditor is owed one million dollars, and that the collateral is worth exactly one million dollars. If the bankruptcy drags on for a year before there is dissolution, our creditor will have lost his $150,000 of interest because he receives no interest unless he is oversecured.[37] Although he might have loaned to another at 15% for that period, he will probably receive nothing for the opportunity cost of losing the use of his money for the year's time.[38] Thus the very presence of the stay,

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Alyucan Interstate Corp. (*In re* Alyucan Interstate Corp.), 12 Bankr. 803, 807-08 (Bankr. D. Utah 1981).

[37] The claim of an undersecured creditor is divided into two parts; it is a secured claim to the extent of the collateral's value, but any claim in excess of that amount is a separate unsecured claim. Interest on the debt is allowed only to the extent the value of the collateral exceeds the amount of the secured claim. 11 U.S.C. § 506(b) (Supp. V 1981). *See also* Crocker Nat'l Bank v. American Mariner Indus. (*In re* American Mariner Indus.), 27 Bankr. 1004, 1009 (Bankr. 9th Cir. 1983) (undersecured creditor not entitled to receive interest); *In re* Pine Lake Village Apt. Co., 19 Bankr. 819, 826-27 (Bankr. S.D.N.Y. 1982) (interest provision held applicable only to oversecured claims).

[38] *See* Fortgang & King, *The 1978 Bankruptcy Code: Some Wrong Policy Decisions*, 56 N.Y.U. L. Rev. 1148, 1163 n.57 (1981). Whether a secured creditor will be compensated for his "opportunity cost" depends upon the court's perception of the nature of adequate protection. Most courts, especially bankruptcy courts, view adequate protection as solely intended to protect the secured creditor against any decrease in the value of his collateral during the interim between the filing of the petition and confirmation of a plan. *See, e.g.*, Crocker Nat'l Bank v. American Mariner Indus. (*In re* American Mariner Indus.), 27 Bankr. 1004, 1009 (Bankr. 9th Cir. 1983); General Elec. Mortgage Co. v. South Village, Inc. (*In re* South Village, Inc.), 25 Bankr. 987, 989 (Bankr. D. Utah 1982); *In re* Pine Lake Village Apartment Co., 19 Bankr. 819, 823 (Bankr. S.D.N.Y. 1982). These courts take the position that because adequate protection is not meant to maintain a secured creditor in the position he could have been in but for the intervention of the stay, or to protect either the value of money or any existing equity cushion, the secured creditor with collateral appreciating or remaining constant in value has gotten

first widely used under rule 11-44 promulgated in 1974, and now applicable via section 362 to all forms of bankruptcy proceedings, will have a deleterious impact upon the secured creditor.

This change first came about by rule, but one should not minimize the impact of the Congressional enactment of the substance of the rule. Section 362 is now in the statute for all to see; it is the topic of continuous discussion in continuing education courses and in the bankruptcy literature, and it is the subject of untold cases.[39] Doubtless this new-found prominence has brought it to the attention of debtors' lawyers, trustees in bankruptcy, and others who will assert its protection but who might have never sought the protection of a rule.

B. Debtor's Retention, Use, and Sale of Collateral

Section 363 of the Code explicitly authorizes the debtor in possession to "enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing" and to "use the property of the estate in the ordinary course of business without notice or a hearing."[40] Prior to the enactment of the Bankruptcy Reform Act, the debtor in possession probably had rights similar to those expressed in section 363 in Chapter X proceedings but that was

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the benefit of his bargain and is entitled to nothing more. *See, e.g.*, General Elec. Mortgage Co. v. South Village, Inc. (*In re* South Village, Inc.), 25 Bankr. at 994; *In re* Pine Lake Village Apartment Co., 19 Bankr. at 827. One court has found that oversecured creditors eventually get their "opportunity cost" through the operation of section 506(b) and suggested that creditors concerned about undue delay should seek dismissal of the petition or conversion to liquidation proceedings. *See In re* Pine Lake Village Apartment Co., 19 Bankr. at 827.

Other courts have focused more specifically on language in the legislative history indicating that a secured creditor should receive in value "essentially what he bargained for." These courts note that were it not for the stay, the creditor would foreclose and thus have the use of his money at current market rates. They argue that because part of what the creditor bargained for was the return of his money at a specified time, he is entitled to compensation for the loss of the use of his money during the interim period between the filing of the petition and confirmation. *See, e.g.*, Metropolitan Life Ins. Co. v. Monroe Park (*In re* Monroe Park), 17 Bankr. 934, 940 (D. Del. 1982); United Virginia Bank v. Virginia Foundry Co. (*In re* Virginia Foundry Co.), 9 Bankr. 493, 498 (W.D. Va. 1981).

[39] A search for cases dealing with section 362 and containing the words "automatic stay" showed 518 cases between January 1, 1982 and April 1, 1983.

[40] Bankruptcy Reform Act of 1978 § 363(c)(1), 11 U.S.C. § 363(c)(v) (Supp. V 1981).

not true either in the most common form of reorganizations, Chapter XI proceedings, or in liquidations.[41] Although the court could stay a creditor's repossession in Chapter XI and presumably permit the use of equipment pending the outcome of the reorganization, its right to authorize the sale of collateral or any serious use that might cause depreciation was far from certain. Thus, the bold and explicit assertion of such rights in all forms of bankruptcy proceedings greatly strengthens the debtor's hand in negotiating with the creditor over the use and sale of such collateral.

Under section 363 the debtor in possession may use the collateral out of the ordinary course or make sales out of the course

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[41] The bankruptcy court's power to sell assets, either subject to or free from liens, was well established under the Bankruptcy Act and its Rules as well as in the accompanying case law. *See* Bankruptcy Act of 1898 § 70(f), (g), 11 U.S.C. § 110 (1970) (repealed 1978); 11 U.S.C. Bankr. R. 606 (Supp. V 1975) (repealed 1978); Wright v. Union Central Life Ins. Co., 304 U.S. 502, 517 (1938); Ray v. Norseworthy, 90 U.S. (23 Wall.) 116, 135 (1875). While Chapter X and Chapter XII had statutory language in sections 257 and 507 that permitted ouster of secured creditors in possession, early cases were hesitant regarding the use of cash proceeds such as rent. *See, e.g.*, Crystal v. Green Point Sav. Bank (*In re* Franklin Garden Apartments, Inc.), 124 F.2d 451, 454 (2d Cir. 1941); National Builders Bank v. Schwartz (*In re* Moulding-Brownell Corp.), 101 F.2d 664, 666 (7th Cir. 1939). During the early 1950's two circuit courts gave thorough consideration to the use of collateral issue with divergent results. In Reconstruction Fin. Corp. v. Kaplan, 185 F.2d 791 (1st Cir. 1950), the First Circuit ordered a turnover of the collateral based on a strong showing that the secured creditor's position would be safeguarded and enhanced. 185 F.2d at 798. The Second Circuit adopted a somewhat more restrictive approach two years later, permitting use of collateral only when there is "a high degree of likelihood (a) that the debtor can be reorganized in accordance with the Act, within a reasonable time, and (b) the secured creditors whose security is being compulsorily loaned will not be injured." *In re* Third Avenue Transit Corp., 198 F.2d 703, 706-07 (2d Cir. 1952). Subsequent decisions recognizing the difficulty in determining the likelihood of successful reorganization at the outset of proceedings substantially eroded the "Third Avenue Test." *See, e.g., In re* Chicago, R.I. & Pac. R.R., 545 F.2d 1087, 1090 (7th Cir. 1976); Central R.R. v. Manufacturers Hanover Trust Co., 421 F.2d 604, 607-08 (3d Cir.), *cert. denied*, 398 U.S. 949 (1970). In addition, two Second Circuit Chapter X decisions permitting continued use of depreciating collateral raised grave doubt as to the viability of *Third Avenue*. *See In re* Bermec Corp., 445 F.2d 367, 369 (2d Cir. 1971); Fruehauf Corp. v. Yale Express Sys. (*In re* Yale Express Sys.), 384 F.2d 990, 992 (2d Cir. 1967). Finally, some Chapter XI cases permitted the continued use of collateral such as inventory and accounts receivable but only so long as the secured creditor's rights were preserved. *See* Citicorp Business Credit, Inc. v. Blazon Flexible Flyer, Inc. (*In re* Blazon Flexible Flyer, Inc.), 407 F. Supp. 861, 863-64 (N.D. Ohio 1976) (accounts receivable); *In re* American Kitchen Foods, Inc., 9 Collier Bankr. Cas. 2d (MB) 537, 542-47 (D. Me. 1976).

only after a notice and hearing.[42] Both the right to use and to sell are dependent upon the capacity of the debtor to give the secured creditor "adequate protection" as that term is defined in section 361. If the debtor in possession can convince the court that his proposal affords "adequate protection," the debtor may proceed on his merry way without significant interference from the secured creditor.

In theory, adequate protection under section 361 should leave the secured creditor in no worse position upon dissolution or the proposal of a plan than he would have been had he received his collateral on the day the petition was filed. In fact, one suspects that it is only by chance that the secured creditor will be left in an identical position after the passage of time. A variety of the forms of adequate protection that have been approved by the courts depend upon hotly debated court determinations of the "value" of the collateral. For example, it is now commonplace for courts to refuse to lift the stay and to find that a secured creditor has "adequate protection" because there is an "equity cushion."[43] Because the value of collateral exceeds the debt, the court finds that the secured creditor will lose nothing by waiting. Obviously, if the court proves to be wrong about the value, or if the collateral depreciates more rapidly than the court expects, the secured creditor will be worse off at the conclusion than he would have been had he received the collateral at the

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[42] The "notice and a hearing" required before cash collateral can be utilized by a trustee does not mean that an actual hearing must be held. 11 U.S.C.]!e 102(1) (Supp. V 1981). *See also In re* Sullivan Ford Sales, 2 Bankr. 350 (Bankr. D. Me. 1980).

[43] *See, e.g., In re* Ware Spaces, Inc., 7 Bankr. Ct. Dec. (CRR) 48 (Bankr. D. Hawaii 1980) (value $3.3 million; debt $2.4 million); Ingersoll-Rand Fin. Corp. v. 5-Leaf Clover Corp. (*In re* 5-Leaf Clover Corp.), 6 Bankr. 463, 466 (Bankr. S.D. W. Va. 1980); City Nat'l Bank v. San Clemente Estates (*In re* San Clemente Estates), 5 Bankr. 605, 610 (Bankr. S.D. Calif. 1980); Heritage Sav. & Loan Assoc. v. Rogers Dev. Corp., 2 Bankr. 679, 684-85 (Bankr. E.D. Va. 1980) (equity cushion of 17.4%); Vlahos v. Pitts (*In re* Pitts), 2 Bankr. 476, 478-79 (Bankr. C. D. Calif. 1979) (equity cushion of 15.3%). *But see* Bankers Life Ins. Co. v. Alyucan Interstate Corp. (*In re* Alyucan Interstate Corp.), 12 Bankr. 803, 810-12 (Bankr. D. Utah 1981) (equity cushion analysis rejected when accrual of interest would dissipate cushion within one year); Bamerical Mortgage & Fin. Co. v. Paradise Boat Leasing Corp., 2 Collier Bankr. Cas. 2d (MB) 1153, 1156-57 (Bankr. D. V.I. 1980) (automatic stay lifted despite equity cushion because of mobility and risk inherent in the operation of a seagoing vessel).

outset.[44] In other circumstances, the creditor stands to lose, because the debtor will have an opportunity to transform inventory or equipment into cash or other liquid assets, and ultimately to dissipate them in a vain attempt to continue the operation of the business. That is a real possibility when the debtor is permitted to use cash collateral, notwithstanding the creditor's objection, or on the basis of an ex parte court order procured without the representation of a lazy or distant creditor.

Although I know of no empirical data[45] to prove that the combination of sections 362, 363, and 361 leads to a lower return for the secured creditor than it would have received had it proceeded under state law to repossess and resell the collateral, that result seems inevitable. It is the hope of many business debtors to be reorganized, to come upon the dawn of new business successes. It is the dark reality that many Chapter 11's become Chapter 7 liquidations.[46] That being the case, it is implausible

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[44] The general rule found in section 502(b)(2) states that no interest can be accrued as part of an allowed secured claim after a petition has been filed. An exception is provided in section 506(b) whereby an oversecured creditor is allowed interest on his claim, but only to the extent his claim is exceeded by the value of the collateral after recovery of any reasonable necessary costs connected with the preservation or disposal of the collateral. The amount of interest allowable under section 506(b) is not calculated until a plan is confirmed or the collateral is sold and once accrued interest on an allowed secured claim equals the amount of the excess, no further interest is allowable. Moreover, at least some courts will refuse to lift the automatic stay on absence of adequate protection grounds merely because the excess is insufficient to cover accruing interest. *See* Crocker Nat'l Bank v. American Mariner Indus. (*In re* American Mariner Indus.), 27 Bankr. 1004, 1007-1010 (Bankr. 9th Cir. 1983). *But see* Metropolitan Life Ins. Co. v. Monroe Park (*In re* Monroe Park), 17 Bankr. 934, 937-41 (D. Del. 1982); Midlantic Nat'l Bank v. Anchorage Boat Sales (*In re* Anchorage Boat Sales), 4 Bankr. 635, 640-44 (Bankr. E.D.N.Y. 1981). Thus, a creditor oversecured when bankruptcy proceedings commence ultimately may discover that because the value of his collateral has not kept pace with the accrual of interest and other expenses incurred by the estate, he is no longer entitled to the compensation he originally anticipated.

[45] The very fact of the huge amount of litigation under § 362 suggests at least secured creditors believe they are being injured by its application.

[46] For example, in the district of Utah, as of September 30, 1982, plans had been confirmed in only 43 of the 251 cases that had been filed and pending for over six months. Probably most of the remaining 208 cases (84%) have been or will be converted into Chapter 7 liquidations. *See In re* Colonial Ford, Inc., 24 Bankr. 1014, 1022, 1022 n.18 (Bankr. D. Utah 1982).

For a sampling of cases that started out as Chapter 11's and have since become Chapter 7 liquidations, see Air Transport Ass'n of America v. Professional Air Traffic Controllers Org. (*In re* Professional Air Traffic Controllers Org.), 699 F.2d 539 (D.C. Cir.

that most collateral will expand in value during the final desperate days of a business slipping from reorganization into liquidation.

C. Cramdowns, Chapter 11 and 13

Under Chapter 13 plans and Chapter 11 reorganizations, the debtor essentially has the power to force any given secured creditor to forego its right to repossess in return for a promise, secured by the collateral, which in the court's judgment has the same present value as the value of the collateral.[47] Thus if the court concludes that a creditor with a two million dollar debt has collateral worth one million dollars, it has the power to approve a plan over the creditor's objection under which the creditor would receive a series of periodic payments whose present value would amount to one million dollars.

In Chapter 13 and Chapter 7 consumer bankruptcies, the cramdown provisions operate together with section 722. That section specifically allows the debtor to redeem certain personal property, usually an automobile, by paying the secured creditor the current value of the asset. Although a Chapter 7 debtor may have to provide a lump sum equal to that value,[48] the debtor

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1983); Roslyn Savings Bank v. Comcoach Corp. (*In re* Comcoach Corp.), 698 F.2d 571 (2d Cir. 1983); Fanelli v. Hensley (*In re* Triangle Chemicals), 697 F.2d 1280 (5th Cir. 1983); Ohio v. Kovacs (*In re* Kovacs), 681 F.2d 454 (6th Cir. 1982); Earl Realty v. Leonetti (*In re* Leonetti), 28 Bankr. 1003 (E.D. Pa. 1983); Pearlstein v. Small Business Administration, 27 Bankr. 153 (D.C. Cir. 1982); Kopelman v. Halvajian (*In re* Triangle Laboratories, Inc.), 663 F.2d 463 (3d Cir. 1981); Superscope, Inc. v. Brookline Corp., No. 81-980-Z (D. Mass. January 25, 1983) (available on Lexis, Bankr. library, Cases file); Levine v. First Nat'l Bank of Lincolnwood (*In re* Evanston Motor Co.), 26 Bankr. 998 (N.D. Ill. 1983); Vogel v. Triangle Equip. Co. (*In re* Triangle Equip. Co.), 26 Bankr. 175 (W.D. Va. 1982).

[47] 11 U.S.C. § 1129(b)(2)(A)(i)(II) (Supp. V 1981); 11 U.S.C. § 1325(a)(5)(B) (Supp. V 1981). The statement in the text is not precisely accurate, for creditors in Chapter 11 may elect for treatment under 11 U.S.C. § 1111(b)(2) (Supp. V 1981). A creditor so electing gives up the right to be treated as an unsecured creditor to the extent that he is "undersecured," but the creditor retains a security interest in the collateral equal to the full amount of the debt. Thus, at least in some Chapter 11 cases, a secured creditor may avoid the consequences of an unfair cramdown by foregoing its unsecured claim and clinging to the collateral (in rem) in the hope his evaluation of the collateral is ultimately proven correct.

[48] The legislative history is somewhat unclear whether lump sum payment is required. *See* Lee, *Chapter 13 nee Chapter XIII*, 53 AM. BANKR. L.J. 303, 306-07 (1979)

under Chapter 13 can effectively force the creditor to continue to finance his purchase of the automobile. Formerly, the secured creditor could insist that the debtor pay the entire amount of the indebtedness to retain the automobile.[49] In the absence of restrictions regarding reaffirmation such as those now found in section 524(c), he often would receive a reaffirmation by the debtor for the full amount of the debt.[50] In effect, the debtor would have concluded that his automobile or other asset was worth more to him than to an independent third party. Section 722, in conjunction with Chapter 13 and section 524, deprives the secured creditor of the right to hold out for that higher subjective value allocated to the asset by a particular debtor.

These provisions are perhaps the most radical and important departure from the law and practice existing prior to the Code. Although cramdowns were possible under Chapters X and XII and in railroad reorganizations prior to the enactment of the Code,[51] few businesses and no consumer debtors found themselves in such reorganizations.[52] Section 1129's application of the cramdown to all business reorganizations, and section 1325's application to all Chapter 13 cases, applies a doctrine that formerly related to a minuscule percentage of all bankruptcies to the core

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(*citing* H. Doc. 95-595 at 127, 380).

[49] U.C.C. § 9-506 (1972).

[50] *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 127, 162-64, *reprinted in* 1978 U.S. Code Cong. & Ad. News 6088, 6123-25. Estimates of the number of reaffirmations vary, but one study found that over one-third of those going through straight bankruptcy agreed to reaffirmation of at least some of their debts with nearly half doing so because they wanted to keep the asset; another third said they wanted to pay the creditor. *See* D. Stanley & M. Girth, Bankruptcy: Problem, Process, Reform 59-62 (1971). In another study, over half of those going through bankruptcy had agreed to reaffirmations of debts. *See* H. Jacob, Debtors In Court 109-10 (1969). Once made, such a reaffirmation was enforceable. *See* 3 Collier on Bankruptcy ¶ 524.03 (15th ed. 1979).

[51] Bankruptcy Act of 1898, §§ 77(b), 216(7), 461(11), 11 U.S.C. §§ 205(b), 616(7), 861(11) (1970) (repealed 1978).

[52] For instance, in the year ending June 30, 1979—the last full year the judiciary operated under the Bankruptcy Act—226,476 bankruptcy estates were filed. Only 669 were Chapter XII petitions, 63 were Chapter X proceedings, and none were railroad reorganizations. Bureau of The Census, Statistical Abstract of the United States: 1981 539 (102d ed. 1981). Chapter X was exclusively for corporate debtors while Chapter XII's purpose was to provide much the same relief for individual debtors with respect to real property arrangements as Chapter X furnished corporate debtors. *See* 1 Collier on Bankruptcy ¶ 0.07 (rev. 14th ed. 1974).

of bankruptcy practice, namely consumer plans and business reorganizations. Under Chapter XI of the Bankruptcy Act, courts had no jurisdiction to deal with the claims of secured creditors.[53] While a court might manipulate the stay to induce a secured creditor to take part de facto in the plan, there was no statutory basis for forcing an unwilling secured creditor to take part. Presumably one who waited out the stay had a right to the return of his collateral. There was no authority in Chapter XIII to cramdown, although a secured creditor could agree to a plan.[54]

Why does this power to "cramdown" diminish the creditor's rights? In effect, it deprives the secured creditor of that increment of value which inheres in the collateral because of the debtor's particular need for, or relation to, that collateral. In the crudest case, assume that the secured creditor has a secured interest in the debtor's hunting dog. The dog is a mongrel; it will have no value on the market. Presumably therefore, a plan probably could be approved under which the dog was given to the debtor without any payment whatsoever. That is so despite the fact that the debtor would pay a large sum to keep his hunting dog. Not only might he have an affection for the dog, but he may also have trained the dog to make it uniquely suited to his hunting habits. In effect, the dog has value to the debtor that it has to no other person. This same example can be played out, once removed, if one considers the debtor and his special relationship to his Corvette. Not only may he have a particular affection for this car, but he also knows its idiosyncracies, understands what the noise is when it hits 60 m.p.h., and appreciates the care he

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[53] *See* Peitzman & Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings*, 65 CALIF. L. REV. 1216, 1222-23 (1977).

[54] The treatment of secured claims under Chapter XIII varied widely among the various judicial districts. In part, this was due to the ambiguous language of the statute providing in section 646(2) that, a plan "may include provisions dealing with secured debts severally, upon any terms" while also in section 652(1) prohibiting confirmation of any plan until accepted in writing "by the secured creditors whose claims are dealt with by the plan." While some courts permitted slight modifications of secured creditors' rights, most found no cramdown authority. *See* 5 COLLIER ON BANKRUPTCY 1325.01[2][E][1] (rev. 15th ed. 1983); Countryman, *Chapter XIII Wage Earners' Plans: Past, Present and Future*, 18 CATH. U. L. REV. 275, 286 (1968); Poulos, *The Secured Creditor in Wage Earner Proceedings: Dream versus Reality*, 44 J. NAT'L CONF. REF. BANKR. 68, 69 (1970).

has taken of the automobile. For all these reasons, it may be worth more to him than it is to a third party. Yet the court in Chapter 13 will apply a bluebook value to that automobile, not the higher value the debtor is likely to ascribe to it.[55] Going one step further, there are many similar cases in which a business debtor undergoing reorganization has a particular need for or knowledge of specific inventory or equipment. Because of that, the debtor would be willing to pay a substantially higher amount to retain that equipment than a third party would be willing to pay for it on the market. In all of these cases the probable effect of the cramdown is to deprive the secured creditor of that additional increment of value.

The second and equally important consequence of the cramdown authority is to expand the court's discretion and to allow the court to use it in ways that may be injurious to the creditor's interest. First, the court must determine the value of the collateral, and second, it must determine the value of the

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[55] While some courts have recognized that assets such as automobiles may have value to the debtor higher than any measure of market value, they do not take that incremental subjective value into account when determining the value of the collateral and the concomitant amount of the allowed secured claim; at most the retail replacement cost is utilized. *See* Ford Motor Credit v. Miller (*In re* Miller), 6 Bankr. Ct. Dec. (CRR) 410, 412 (Bankr. S.D. Cal. 1980) (median between wholesale and retail replacement cost is appropriate valuation because it reflects the open market between private parties). Indeed, some courts appear determined not to take into account the debtor's special attachment to the asset. *See* GMAC v. Willis (*In re* Willis), 6 Bankr. Ct. Dec. (CRR) 1101, 1109 (Bankr. N.D. Ill. 1980) (average trade-in value is generally appropriate valuation for automobiles because it reflects what a reasonably willing buyer not under compulsion to buy would pay to a reasonably willing seller not under duress to sell). In *Willis,* the auto in question had been purchased only two weeks prior to the filing of the petition; therefore, the court refused to apply the general evaluation standard because it believed the original contract price constituted better evidence of what a willing buyer would pay and a willing seller would accept. *Id.* One measure of valuation used by several courts is the amount that could be realized upon disposition in a commercially reasonable manner, sometimes taking special notice of the creditor's business or usual means of collateral disposal. *See* Savloff v. Continental Bank (*In re* Savloff), 6 Bankr. Ct. Dec. (CRR) 349, 350 (Bankr. E.D. Pa. 1980); Virginia Nat'l Bank v. Jones (*In re* Jones), 6 Bankr. Ct. Dec. (CRR) 965, 967 (Bankr. E.D. Va. 1980); *In re* Adams, 5 Bankr. Ct. Dec. (CRR) 1234, 1235 (Bankr. M.D. Fla. 1980). In an effort to keep things administratively manageable, some courts simply use the bluebook wholesale value. *See In re* Crockett, 6 Bankr. Ct. Dec. (CRR) 226, 227 (Bankr. E.D. Ill. 1980); *In re* Adams, 5 Bankr. Ct. Dec. (CRR) 1234, 1235 (Bankr. M.D. Fla. 1980). *See also* 11 U.S.C. § 1325(a)(5)(B) (Supp. V 1981).

periodic payments typically given to replace the collateral. The appellate courts are likely to show little interest in redressing factual errors in determining value of collateral or present value of a stream of payments. Thus, one can assume that secured creditors will be made to live with the judgment of the bankruptcy trial judge.

In passing one should consider the argument that can be made to suggest that cramdown power is really no change. Because secured creditors were always willing to negotiate in such circumstances, is there no change? I think not. Formerly a Chapter XI secured creditor could threaten to take his collateral and go home once the stay was lifted. Under the current system, that will be a hollow threat because the debtor in possession can use the cramdown. By substantially changing the likely legal outcome on failure of negotiation, the enactment of these expansive cramdown rules reorders the negotiating power of the parties. Moreover, in the consumer context, section 524's restrictions on reaffirmation back up the cramdown rules.

In summary, the consequences of the various cramdown rules are to grant the bankruptcy court jurisdiction and discretion to determine the value not only of the collateral but also of the future payments, second, to deprive the secured creditor of the "personal" increment of value ascribed by the debtor to the collateral, and in sum, substantially to reallocate the negotiating power among the parties.

D. Avoidance Powers

Reading the cases and talking with those actively involved in bankruptcy practice, one concludes that the avoidance powers are far less significant than provisions such as the cramdown and the automatic stay. Nevertheless, the trustee's avoidance powers have been expanded by the Code in a number of respects. For instance, section 547 on preferences removes the requirement that the trustee prove that the creditor who received a preference had reasonable cause to believe the debtor to be insolvent. Further, the Code provides a presumption of insolvency during

the ninety days prior to the filing of the petition.[56] In addition, it subjects "insider" preferences to attack even though they occurred as long as one year before the petition was filed.[57] Section 547 also explicitly provides for attacking after-acquired property in a way that did not previously exist.[58] The only concessions to the secured creditor are the codification of certain common law exceptions to preferences[59] and the substitution of a ninety-day rule for the four-month rule of the Bankruptcy Act of 1898.[60]

The net consequence of these changes is enhancement of the power of the trustee to set aside transfers. Under current law, the trustee will never lose a suit because he is unable to prove that the creditor who received a transfer lacked a reasonable cause for believing the debtor insolvent or that the debtor was insolvent at the time of the transfer. Now the creditor bears the burden of proving the debtor not insolvent.

Other provisions will have a modest, though perhaps significant effect on certain kinds of secured creditors. Section 544(a)(3) now allows the trustee to set aside unrecorded real estate mortgages that he could not attack under the law of many states prior to the Code.

Finally, section 522(f)(2) voids nonpurchase money nonpossessory security interests in certain consumer goods.[61] Thus, the

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[56] Bankruptcy Reform Act of 1978 § 547(f), 11 U.S.C. § 547(f) (Supp. V 1981).

[57] Bankruptcy Reform Act of 1978 § 547(b)(4)(B), 11 U.S.C. § 547(b)(4)(B) (Supp. V 1981).

[58] Bankruptcy Reform Act of 1978, §§ 547(c)(15), 547(e), 11 U.S.C. §§ 547(c)(5), 547(e) (Supp. V 1981). This paragraph codifies the "improvement in position" test, thereby overruling decisions such as DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969), and Grain Merchants of Indiana, Inc. v. Union Bank & Sav. Co., 408 F.2d 209 (7th Cir.), *cert. denied*, 396 U.S. 827 (1969). Thus if a secured creditor improves his position by acquiring a lien on additional after-acquired receivables and inventory during the ninety days preceding bankruptcy while making no new matching advance, there is a voidable preference to the extent that the security interest increased in value.

[59] Bankruptcy Reform Act of 1978 § 547(c)(1)(4), 11 U.S.C. § 547(c)(1)(4) (Supp. V 1981). *See generally* 4 COLLIER ON BANKRUPTCY ¶ 547.37, 547.40 (rev. 15th ed. 1983).

[60] *Compare* Bankruptcy Reform Act of 1978 § 547(b)(4)(A), 11 U.S.C. § 547(b)(4)(A) (Supp. V 1981) *with* Bankruptcy Act of 1898 § 60(a)(1), 11 U.S.C. § 96(a) (1970) (repealed 1978).

[61] The full text of 11 U.S.C. § 522(f) (Supp. V 1981) provides:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under

classical security interest taken by the small loan company in the debtor's furniture and other household goods, which is neither possessory nor a purchase money security interest, is set aside by section 522.

E. Reach of the Bankruptcy Courts

If one accepts the view that bankruptcy courts are generally less sympathetic to secured creditors' claims than state courts,[62] one finds an independent and significant injury to the secured creditor's interest simply because the secured creditor is now more likely than in the past to find himself before the bankruptcy court. Are the bankruptcy courts more hostile to secured creditors' interests than are the state courts? For a variety of reasons that is a plausible hypothesis. Not only will a bankruptcy judge be armed with the avoidance powers discussed above, he will also be more familiar than a state court judge with the various potential defects in the secured creditors' claims. Unlike the state court judge who must simply determine the narrow dispute before him, the bankruptcy judge is directed to find a way to reorganize the debtor or to make a plan under which the debtor can pay off some significant part of his debts.[63]

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subsection (b) of this section, if such lien is —

(1) a judicial lien; or

(2) a nonpossessory, nonpurchase-money security interest in any —

(A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(B) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(C) professionally prescribed health aids for the debtor or a dependent of the debtor.

[62] A highly unscientific sampling of the opinions of creditors' lawyers tells me that secured creditors view the bankruptcy court as a more hostile forum than state courts. Partly this is because of the specific avoidance powers and because of the powers such as the automatic stay. An articulate spokesman for this view is Paul Festerson. In his article, *Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor and the Doomsday Principle*, 5 CREIGHTON L. REV. 221, 226 (1972), Festerson argues that the courts of bankruptcy have asserted or will assert whatever power is necessary to be exercised in an "altogether discretionary" way to achieve the goals deemed by them to be appropriate.

[63] *See* 28 U.S.C. § 1471 (Supp. V 1981); *see also* Waxman, *A Solution to the Bank-*

If he is true to that mission, he will often come in conflict with the secured creditors' interest, for the typical secured creditor will seek to deprive the estate of assets that may be critical to the reorganization. Finally, there may be deeper reasons, buried in the mode of selection of bankruptcy judges, that bring persons to the bankruptcy bench who initially are more sympathetic to the debtor's plight than are state court judges.

To some extent, Congress itself has given credence to the view that the bankruptcy courts are more generous than state courts. For example, in the 1970 amendments to sections 14 and 17 of the Bankruptcy Act of 1898, the Congress required that certain objections to discharge be presented in the bankruptcy courts, not in the state courts.[64] Likewise, the enactment of the elaborate and difficult reaffirmation ritual in section 524 presumably is based in part on the assumption that the bankruptcy judge will be solicitous of the debtor's interests.

There are two unrelated reasons why a secured creditor is more likely to find himself before a bankruptcy judge under the Code than formerly was the case. The most obvious is the expansion of jurisdiction[65] granting the bankruptcy court jurisdiction over all matters "arising in or related to" Title 11 cases and over all property of the estate "wherever located."[66] Previously, jurisdiction had been restricted to the core bankruptcy functions such as litigation to recover the debtor's assets[67] and had not been extended to such traditionally state law matters as property damage or breach of contract.[68] Moreover, personal jurisdic-

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ruptcy Court Conundrum, 69 A.B.A. J. 312, 312 (1983).

[64] The 1970 addition of § 17(c)(2), together with an amended § 14(f), provided that a creditor objecting to a discharge under § 17(a)(2) (false pretenses, false representations, false financial statements, and willful and malicious conversion), § 17(a)(4) (fraud or defalcation by an officer or a fiduciary), or § 17(a)(8) (other willful and malicious injuries to person or property) must raise his objections in bankruptcy court within the time fixed by the court; if he failed to raise the specified objections in that forum, he was not permitted to do so elsewhere. For criticism of the draftsmanship of the 1970 amendments, see Countryman, *The New Discharge-ability Law*, 45 AM. BANKR. L.J. 1, 25-27 (1971).

[65] 28 U.S.C. § 1471(b), (c) (Supp. V 1981).

[66] Bankruptcy Reform Act of 1978 § 541(a), 11 U.S.C. § 541(a) (Supp. V 1981).

[67] *See* Note, *Bankruptcy and the Limits of Federal Jurisdiction*, 95 HARV. L. REV. 703, 712-13 (1982).

[68] The legislative history of the statute expressly states that under the Bankruptcy

tion under the Bankruptcy Act was essentially limited to actions in rem and actions in which the defendant had consented to the bankruptcy court's jurisdiction.[69] Putting aside the issues raised in *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*,[70] any claim by the trustee to collateral, wherever located, could now be asserted in the bankruptcy court rather than through a private action in a state court.[71] Assuming that the *Marathon* dispute ultimately is resolved in a way consistent with the drafters' intent,[72] adversary proceedings of all kinds will be heard before the bankruptcy court, not in state court as formerly would be the case.

Code bankruptcy courts have "the broadest grant of jurisdiction to dispose of proceedings that arise in bankruptcy cases or under the bankruptcy code." H.R. REP. No. 595, 95th Cong., 1st Sess. 445, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6400. Case law reflects an embracement of the theory. *See, e.g.*, Colgrove v. Hoopa Timber Corp. (*In re* Colgrove), 3 Collier Bankr. Cas. 20 (MB) 839, 841 (Bankr. N.D. Cal. 1981) (jurisdiction); Thompson v. First State Bank (*In re* Thompson), 3 Bankr. 312, 313 (Bankr. D.S.D. 1980) (jurisdiction over allegations of prepetition unlawful seizure of and injury to debtors' property).

[69] *See* 1 COLLIER ON BANKRUPTCY ¶ 3.01[2][a] (rev. 15th ed. 1983). When property was in the actual or constructive possession of a third person asserting a bona fide adverse claim, the bankruptcy court had no jurisdiction to summarily determine that person's claim without his consent. *See* 6 COLLIER ON BANKRUPTCY ¶ 3.05 (rev. 14th ed. 1978). Illustrative of this state of affairs is the secured creditor holding repossessed property as a result of the exercise of self-help enforcement. The case law under the Bankruptcy Code generally deals with these circumstances by finding the secured creditor to be a "custodian" within the meaning of 11 U.S.C. § 101(10)(c) (Supp. V 1981) and thus required to return the property to the estate pursuant to 11 U.S.C. § 543 (Supp. V 1981). *See* ABD Fed. Credit Union v. Williams (*In re* Williams), 6 Bankr. Ct. Dec. (CRR) 1219, 1220 (Bankr. E.D. Mich. 1980). *But see* Flournoy v. City Fin. Inc., 679 F.2d 821, 822-24 (11th Cir. 1982). In any case, the mere presence of a third party holding under an adverse claim of right no longer deprives the court of jurisdiction on that basis alone.

[70] 102 S. Ct. 2858 (1982).

[71] 28 U.S.C. § 1471 (Supp. V 1981); *see also* 1 COLLIER ON BANKRUPTCY ¶ 3.01[1][e] (rev. 15th ed. 1983); Kennedy, *The Bankruptcy Court under the New Bankruptcy Law: Its Structure, Jurisdiction, Venue, and Procedure*, 11 ST. MARY'S L.J. 251, 276-77 (1979); Rendleman, *Liquidation Bankruptcy under the '78 Code*, 21 WM. & MARY L. REV. 577, 580 (1980). Bankruptcy courts exercising the broad personal jurisdiction granted by Congress have deemed themselves authorized to assert personal jurisdiction over parties located anywhere within the United States. *See* Note, *Bankruptcy and the Limits of Federal Jurisdiction*, 95 HARV. L. REV. 703, 713-14 & n.57 (1982).

[72] *See supra* note 68; *see also* H.R. REP. No. 595, 95th Cong., 1st Sess. 445, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6400 ("Actions that formerly had to be tried in State court or in Federal district court, at great expense and delay to the estate may now be tried in the bankruptcy courts.").

The second and unrelated reason for the secured creditor to find itself before the bankruptcy court concerns the many provisions of the Code that now make bankruptcy more palatable both to consumers and to business. For example, the expansion of exemptions in section 522 and the capacity to be discharged from virtually all debts of whatever nature under Chapter 13 now make bankruptcy a suitable alternative for many for whom it would not have been acceptable prior to the Code. Likewise, the cramdown provisions, the stay, and the fact that claims (however contingent) can be resolved in bankruptcy, may bring business debtors to court who formerly would have contented themselves with private negotiations.[73] The radical increase of

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[73] A quick examination of the discharge provisions of Chapter 13 and of the exemption provisions in § 522 shows why individuals who might not have declared bankruptcy prior to the Code may now do so. It is much less obvious why the same might be true of businesses. Doubtless, some businesses will choose Chapter 11 today who previously would not have chosen either Chapter XI or Chapter X because of the expanded powers that are given to the debtor in possession.

There is another class of business debtors that may find it desirable to file in Chapter 11 under the Code and who would not have done so under the prior law. These are debtors whose principal creditors are plaintiffs and potential plaintiffs in mass tort law suits. A current and notorious example of this class is the Johns-Manville Corporation, which filed a Chapter 11 petition in the Southern District of New York in 1982. *See, e.g.*, Johns-Manville Corp. v. Doan (*In re* Johns-Manville Corp.), 7 Collier Bankr. Cas. (MB) 1231 (Bankr. S.D.N.Y. 1983); Johns-Manville Corp. v. Doan (*In re* Johns-Manville Corp.), 26 Bankr. 919 (Bankr. S.D.N.Y. 1983) (earlier opinion in same case on related matters); Johns-Manville Corp. v. Asbestos Litigation Group (*In re* Johns-Manville Corp.), 26 Bankr. 420 (Bankr. S.D.N.Y. 1983) (same). *Johns-Manville* is but the most prominent of these cases. *See, e.g., In re* Related Asbestos Cases, 23 Bankr. 523 (N.D. Cal. 1982); *In re* UNR Industries, Inc., 23 Bankr. 144 (Bankr. N.D. Ill. 1982). In addition, the potential exists for a similar result in a variety of other cases where corporate defendants are confronted with a large number of tort plaintiffs. None of these cases would have found their way into the bankruptcy court under the old law.

Under the Bankruptcy Act of 1898 (as it existed in 1978) only provable and allowable claims were discharged. Certain claims, such as those arising out of intentional torts, could not be proved and therefore were not discharged. Negligence claims could be "proved" only if the debtor had been sued on the claims before the bankruptcy proceedings were initiated. Even if the claim was provable, it was not allowable if it could not be liquidated or reasonably estimated, or if that estimation would unduly delay the administration of the estate. Thus, under the Bankruptcy Act it was unlikely that a defendant could escape liability even to plaintiffs who had filed suit; it was impossible that he would escape liability to potential litigants.

Under the Code, Congress dispensed with the concept of provability. Moreover, it directed the court to fix the value of all contingent and unliquidated claims, regardless of their capacity for reasonable estimation. Thus, it became not a matter of discretion with

consumer bankruptcies over the last several years is partly attributable to the recession. A large part of that increase, however, must also be attributable to the new provisions that make bankruptcy more palatable.[74]

The combination of these events, expanded jurisdiction, and the increased willingness of those to go into bankruptcy, means that the secured creditor will now find itself more often than before in front of a judge that is armed with avoidance power, with the knowledge of creditors' foibles, with the directions to foster reorganizations and protect debtors, and conceivably with an anti-creditor bias.

F. Fraudulent Conveyance and Foreclosure Sales

One of the events that has large potential for diminishing secured creditor rights rises from the cases, not from rules or

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the bankruptcy court, but a matter of obligation to estimate such claims.

In circumstances such as existed in *Johns-Manville*, courts ultimately may refuse to deal with most such claims. In the first place, courts may find that the more remote claimants (those who have not filed suit and those who may have been exposed to asbestos but show no symptoms of illness) are not yet "claimants," and thus are untouched by the bankruptcy proceedings. Particularly with respect to those whose claims are remote, there are important due process questions about whether one should permit one's rights to be extinguished at a time when one may be ignorant of those rights. For a discussion of some of the questions associated with estimating such claims, see Note, *Procedures for Estimating Contingent or Unliquidated Claims in Bankruptcy*, 35 STAN. L. REV. 153 (1982).

[74] In the twelve month period ending June 30, 1981, the first full statistical year under the Bankruptcy Code, a total of 360,329 cases representing 518,152 estates were commenced in bankruptcy courts. This was the largest number of bankruptcy estates ever filed in one year and a 43.8% increase over the previous record high set in 1980. Business bankruptcies also increased but remained in the same ratio to former total estates. *See* 1981 ANNUAL REPORT OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 131-36. Using a regression model, one commentator calculates that the new Bankruptcy Code may be directly responsible for as much as a third of the increase in personal bankruptcy filings. *See* Kowalewski, *Personal Bankruptcy: Theory and Evidence*, FED. RESERVE BANK OF CLEVELAND ECON. REV. 1 (Spring 1982); *see also Bankruptcy Reform Act of 1978: Hearings Before the Subcomm. on Courts of the Comm. on the Judiciary*, 97th Cong., 1st Sess. 13 (1981) (statement of Arthur F. Brimmer, President, Brimmer & Co., Economic and Financial Consultants); Evans & Johnson, *Proposals for Consumer Bankruptcy Reform*, 37 BUS. LAW. 1117 (1982); Martin, *Creditor Alternatives to Obtain Relief from Automatic Stays in Bankruptcy*, 87 COM. L.J. 22, 22 (1982). *But cf.* Petzinger, *A Bankruptcy Boom*, 2 CAL. LAW. 32, 36 (1982) (describing reluctance of businesses to file for bankruptcy even when it is their only hope).

statutes. In *Durrett v. Washington National Insurance Co.*,[75] the Fifth Circuit applied the law of fraudulent conveyances in a novel and potentially damaging way to foreclosure sales. In that case, the trial court found the fair market value of the collateral to be $200,000. Neither party challenged that finding on appeal, but the trustee argued that the foreclosure sale for $115,400 (57.7% of the fair market value) was not "the fair equivalent" for the transfer of that property. Consequently, he maintained that it was voidable under section 67 of the Bankruptcy Act. Agreeing with that argument, the court suggested that anything less than 70% of the fair market value would not be the fair equivalent. That case has been followed in a subsequent Fifth Circuit opinion, *Abramson v. Lakewood Bank & Trust Co.*,[76] over the dissent of Judge Clark. It has been explicitly rejected by the bankruptcy panel for the Ninth Circuit in *Lawyers Title Insurance Corp. v. Madrid (In re Madrid)*,[77] and by several other courts.[78]

Note first that *Durrett* can be applied just as readily under the Code as under the Act of 1898. The important language in section 67(b) appears now in section 548. Indeed, it may be easier to reach the result under the Code.[79] Moreover, there is noth-

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[75] 621 F.2d 201 (5th Cir. 1980).

[76] 647 F.2d 547 (5th Cir. 1981). It has also been followed unenthusiastically by some bankruptcy courts. *See* Perdido Bay Country Club Estates, Inc. v. Equitable Trust Co. (*In re* Perdido Bay Country Club Estates), 23 Bankr. 36, 39-40 (Bankr. S.D. Fla. 1982) (sale for 70% of fair market value held reasonably equivalent); Coleman v. Home Sav. Ass'n (*In re* Coleman), 21 Bankr. 832, 834 (Bankr. S.D. Tex. 1982) (sale for 28% of fair value held not reasonable equivalent); Wickham v. United American Bank (*In re* Thompson), 18 Bankr. 67, 70 (Bankr. E.D. Tenn. 1982) (sale for 80% of fair value held reasonably equivalent).

[77] 21 Bankr. 424 (Bankr. 9th Cir. 1982).

[78] *See, e.g.*, Cooper v. Smith (*In re* Smith), 24 Bankr. 19, 23-24 (Bankr. W.D.N.C. 1982); Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 Bankr. 434, 448 (Bankr. D. Utah 1982); Murdock v. Plymouth Enterprises, Inc. (*In re* Curtina Int'l, Inc.), 23 Bankr. 969, 975 (Bankr. S.D.N.Y. 1982); Home Life Ins. Co. v. Jones (*In re* Jones), 20 Bankr. 988, 994-95 (Bankr. E.D. Pa. 1982).

[79] The most significant difference between the provisions of the old Bankruptcy Act and those of the new Bankruptcy Code regarding constructively fraudulent conveyances is the latter's elimination of any element of good faith in determining whether the debtor received fair consideration. *Compare* Bankruptcy Act of 1898 § 67(d)(1), 11 U.S.C. § 107(d)(11) (repealed 1978) *with* Bankruptcy Reform Act of 1978 § 548(a)(2), 11 U.S.C. § 548(a)(2) (Supp. V 1981). An insolvent who receives less than reasonably equivalent

ing that necessarily restricts *Durrett* to real estate foreclosures; it would be just as easy to reach that result in the resale of an asset under Article 9. If *Durrett* is generally accepted, nearly all sales of repossessed collateral will be subject to attack under section 548 if the debtor goes into bankruptcy within one year of the sale. The trustee may be able to reach back beyond one year by using section 544 and subrogating himself to one who would have a claim under the state fraudulent conveyance law.

As Judge Clark points out in his dissent in *Abramson*, the likely result of such a rule is to cause those who bid at foreclosure sales to reduce their bids by some increment equal to the probability that the debtor will go into bankruptcy and that some trustee will make the buyer disgorge the property.

To the creditor such a consequence will mean that he will place less reliance upon his collateral for two reasons. First, he will expect to receive less on foreclosure than he would have otherwise, because others will discount the price. Second, he can expect to be embroiled in further litigation with the disappointed buyer if the foreclosure sale is upset. The cases to date do not elaborate the potential liability that the secured creditor might have in such circumstances.[80] In these instances it is conceivable that the secured creditor will give an express or implied warranty of title. Thus, it is possible that the disappointed buyer would come back to the secured creditor and would insist that the secured creditor take his position and pursue the claim in the bankruptcy estate.

One can hope that the view of the bankruptcy panel for the

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value—a concept that readily lends itself to mathematical formulation—for property has made a fraudulent transfer; the state of mind of the transferee is not important. *See* 4 COLLIER ON BANKRUPTCY ¶ 548.02[4] (rev. 15th ed. 1983).

[80] Thus far, courts have focused on the rights of the trustee or debtor in possession to recover the property transferred pursuant to § 550(a) and the rights of the disappointed buyer under § 548(c) and § 550(d) to a lien on the property transferred at least equal to the foreclosure price. They have not considered whether a disappointed buyer may, in addition to or in lieu of enforcing the § 548(c) lien, impose liability on the secured creditor for whose benefit the foreclosure occurred. *See* Gillman v. Preston Family Inv. Co. (*In re* Richardson), 23 Bankr. 434, 448-49 (Bankr. D. Utah 1982); Coleman v. Home Sav. Ass'n (*In re* Coleman), 21 Bankr. 832, 836-37 (Bankr. S.D. Tex. 1982); Smith v. American Consumer Fin. Corp. (*In re* Smith), 21 Bankr. 345, 352 (Bankr. M.D. Fla. 1982); Home Life Ins. Co. v. Jones (*In re* Jones), 20 Bankr. 988, 994-96 (Bankr. E.D. Pa. 1982).

Ninth Circuit will prevail. It is far better to attack inappropriate and unfair foreclosures frontally by asserting (a'la U.C.C. section 9-504) that they are not "commercially reasonable" than by coming in the back door. The *Durrett* approach introduces unnecessary uncertainty; by granting some unidentified court authority to find the sale price was less than 70% of the "value," it casts a cloud over virtually every foreclosure proceeding. At this writing, there are two decisions by one court of appeals asserting this idea; no other courts of equal status have addressed it.[81]

II. Creditor Responses

A. Introduction

If this combination of rules, cases, and the enactment of the Bankruptcy Reform Act of 1978 has significantly reduced creditors' rights, one can be certain that creditors and their lawyers are busy with schemes to recoup their losses. The nature of creditor responses are important for a variety of reasons. They are important to everyone actively involved in bankruptcy practice, for they will tell us whether the rules that have been established, as discussed above, will in fact apply or whether they will be circumvented by the creditors' actions. They are important for the economists because they will give some insight on the grand question whether security is sufficient; they may also instruct on a narrower question—whether the changes wrought by the Code will produce a more efficient system than previously existed. For similar reasons, the creditor responses are important to legislators, for only by assessing them can the legislator determine whether the goal of greater equity and fairness has been achieved and at what cost. Most significantly, the efficiency of these responses are important to the creditors themselves. Secured creditors ultimately may conclude that attempting to gain security, or something like it, is so difficult and inefficient that they may as well become unsecured creditors.

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[81] Aside from the *Madrid* decision, all courts that have considered and rejected *Durrett*'s seventy percent rule have been bankruptcy courts. *See supra* notes 76-77 and accompanying text.

One can easily visualize at least six creditor responses to the events described in Part I of this paper. I do not argue that this is an exclusive list; I am confident that it is not. Most of the devices discussed below are now in use as security substitutes. I suggest only that their use will become more widespread. History tells us, however, that one should not underestimate the creditors' imagination. Surely they will devise modes of operation more intricate and elegant than any law professor could conceive. Only time will reveal those to us; for now, consider six possible responses.

First is the creditor's retention of ownership of assets that might otherwise belong to the debtor. Examples are leasing and consignment. Second is the possibility of the creditor's purchase of assets from the debtor, classical factoring and perhaps more. Third, one can expect the creditor to take a broader security interest than before. Fourth, many creditors will insist upon a guaranty in circumstances where one might not have been required before. Fifth, a combination of debtors and creditors may attempt to allocate part of the cost to the taxpayers in the form of government guarantees. Finally, secured creditors are likely to charge higher rates in an attempt to offset the cost imposed by their inability to enjoy the full value of their collateral.

B. Lease and Consignments

Leasing and consignments are two forms of purchase money financing with a long history in the law of creditors' rights. For many reasons creditors have often written security agreements in the form of leases.[82] If one writes this contract as a "true

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[82] The initial reason, which may still have vitality, for writing a transaction as a lease was to insure that the "lessee" would get a deduction as a business expense for the full amount of his payment. If he were treated as a purchaser under the federal income tax law, the lessee would have been entitled to a depreciation deduction; that deduction was often not as large as the full amount of the payment. Second, the debtor sometimes may wish to lease rather than buy to avoid showing a liability on its balance sheet. Third, a buyer may be prohibited from certain types of borrowing by agreements made as part of earlier loans. In some circumstances, additional borrowing as a part of a "purchase" transaction will violate these provisions, but a "lease" of the same asset will not. Finally, there also may be state tax considerations for leasing. Note that the Uniform Commercial Code has accomodated to this problem by permitting those who wish to characterize their transactions as leases nevertheless to file under § 9-408.

lease," the legal rules that apply to it are unambiguous under the Bankruptcy Code, under Article 9 of the UCC, and under the common law of the various states. The same is not true of a consignment. The Uniform Commercial Code inartfully deals with consignment. It is not clear, to me at least, that one can write a consignment that will not be treated as a security agreement under Article 9. This uncertainty under the UCC is certain to spawn additional uncertainty for the consignor under the Code.

Turning first to the lease, what happens if the creditor chooses to characterize himself as a lessor and to write his agreement as a true lease? Both the Uniform Commercial Code and the Code recognize him as such. Under the Uniform Commercial Code, a true lease is outside of Article 9; it simply constitutes a contract with respect to goods, and it is enforceable according to the common law of bailment of the particular state.[83] Under the Code, a lease typically would be treated under section 365, the provision dealing with executory contracts and leases.

Upon the bankruptcy of the lessee, the lessee and his trustee have two options. If they decide to reject the lease, they must forfeit the goods to the lessor, who takes the goods and may assert certain limited rights against the bankrupt estate as an unsecured creditor. Note, however, there is no option or discretion on the part of the trustee to argue that the asset is worth less than the lessor believes it to be worth, and thus, it may be retained in a plan for payment equal to something less than the lease payments. If the trustee or the debtor instead chooses to assume the lease, he has the responsibility of curing any existing default,[84] and then must comply with the lease, term by term. The full amount of the payments provided for in the lease must be made, and they must be made under the same schedule as provided in the lease. To repeat, the court has no option such as exists under section 1129 to conclude that the leased goods have a value less than that represented by the payments provided under the lease, and thus, to authorize lower payments or the

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[83] J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 977 (2d ed. 1980).

[84] Bankruptcy Reform Act of 1978 § 365(b)(1)(A), 11 U.S.C. § 365(b)(1)(A) (Supp. V 1981).

same payments over a longer term.

In view of these provisions and the recognition of the lessor's right as an owner, some have suggested that those who formerly would have cast their transaction as a security interest might now wish to write it as a true lease.[85] In most circumstances, a true lease cannot have exactly the same economic consequences and risks as a security agreement. In the classical lease, the lessor assumes the risk that the leased goods will depreciate more rapidly than he contemplates at the outset; on the other hand, the lessor also enjoys the benefit that arises from appreciation in the leased goods. In a sale and security agreement both the risk and benefit rest with the debtor. Typical documents in current use as "leases" have some of the attributes of a classical lease and some of the attributes of a standard security agreement. Should the lease be written for the entire useful life of the collateral, or should it provide that the risk of excessive depreciation rests with the debtor, the lessor runs the risk of having a court conclude that the "lease" is in fact a security agreement.[86] Thus to enjoy the benefits of section 365, the

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[85] *See* Koch, *Bankruptcy Planning for the Secured Lender*, 99 BANKING L.J. 788, 790-92 (1982).

[86] If the lease is determined to grant a security interest that has not been perfected, the creditor-would-be-lessor clearly loses to the trustee. Unfortunately, it is difficult to be certain that a lease will not be held a security agreement because that is to be determined by the facts of each case. U.C.C. § 1-201(37) (1972). When, at the end of the lease term, the lessee gets the asset for no additional consideration, or at only token consideration such as one or two dollars, the lease will be held a security agreement. *See, e.g.*, Bolen v. Mid Continent Refrigerator Co., 411 N.E.2d 1255, 1258 (Ind. Ct. App. 1980) (lessee could receive title to refrigerator for $1 and sales tax; held security interest). The mere presence or absence, however, of an option to purchase is not determinative whether the device is held a lease or security interest. *See, e.g., In re* Tilery, 571 F.2d 1361, 1366 (5th Cir. 1978) (absence of purchase option not an obstacle to finding security interest); *In re* Winston Mills, 6 Bankr. 587, 597 (Bankr. S.D.N.Y. 1980) (parties' intent to be determined from economic substance of their agreement); Adelman v. GMAC (*In re* Tulsa Port Warehouse Co.), 4 Bankr. 801, 805 (Bankr. N.D. Okla. 1980) (substance considered over form to decide whether agreement constitutes lease or security interest); Van Alphen v. Robinson, 420 N.Y.S.2d 44, 46 (1979) (presence of purchase option does not preclude device from being a lease).

In general, courts have tended to employ some form of an "economic realities" test whereby a purported lease will be held a security interest if the only sensible business decision at the end of the lease term would be to acquire the asset in question. *See, e.g.*, Percival Constr. Co. v. Miller & Miller Auctioneers, Inc., 532 F.2d 166, 172 (10th Cir. 1976) (purchasing as lessee's only viable business choice); Citicorp Leasing v. Allied In-

creditor may have to give up certain protections and accept certain risks that would not have been imposed upon him, at least under the pre-Code bankruptcy law.

Arguably, section 2-326 is a substantive rule of law that assigns certain rights to the parties in any consignment transaction. Specifically, section 2-326(2) provides, "goods held on sale or return [i.e., on consignment] are subject to such [buyers', creditors'] claims while in the buyers' possession." The section provides that the consignor can buy protection against such creditors by filing a financing statement. Section 9-114 of the 1972 amendments elaborates on those rights. That section contemplates that certain consignments are "intended as security" and others are not. Section 1-201(37), dealing with security interests, specifies that even consignments not intended as "security interests" are subject to the provisions under section 2-326.

The combination of these sections leaves considerable uncertainty. Conceivably, section 2-326 is stating that, irrespective of the parties' intent or the language of their agreement, the consignee's creditors will have rights in the collateral superior to those of the consignor unless there is a filing. In short, one can read section 2-326 as a rule of substantive law to the effect that any consignment is the conveyance of a property interest to the consignee sufficient to give an interest in his creditors superior to that of the consignor.[87] Note, this is in marked contrast to the Uniform Commercial Code's application to true leases; it leaves such questions to the common law of the state, which would find the interest of the lessee's creditors subordinate to the lessor's interest. On the other hand, one may read the references to consignments "intended as security" to mean that a carefully constructed consignment gives the consignee and his creditors no greater rights than a lessee would have.

Under Article 9, if the consignor files a financing statement, all of this is academic. By filing he gains superiority over other

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stit. Distrib., 454 F. Supp. 511, 516 (W.D. Okla. 1977) (lessee's onlv reasonable course was to purchase; held, security agreement). Thus, to be as certain as possible that his lease will not be held a security agreement, a creditor should charge the equivalent of the fair market value of the asset at the end of the lease term.

[87] *See generally* J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 883-88 (2d ed. 1980).

competitors. In bankruptcy, however, it is not academic. If we treat the consignor merely as a secured creditor in bankruptcy, he will then be subject to cramdowns under sections 1325 and 1129 of the Code. On the other hand, if we treat him as the true owner of the property, subject only to a contract, there will be no possibility of a cramdown and the debtor in possession will obtain rights to the collateral only by adopting the contract under section 365 of the Code and living up to all of its terms.

Presumably, the different treatment of consignments and leases under the UCC is attributable in part to the fact that consignments were already a well-developed mode of financing at the time the UCC was enacted, whereas leasing was not as widely recognized as a financing substitute. Perhaps more important, the expectation of a competing creditor who sees goods, apparently part of inventory but in fact on consignment, is different from the expectation of the creditor who sees goods in use as equipment, and apparently on lease. Presumably, the former has greater potential for misleading creditors than the latter.[88] If any possible misperception by competing creditors has been solved by a public filing under Article 9, what is the basis in bankruptcy for giving one treatment to consignments and another to leases? I am uncertain that there is any. By hypothesis both of these transactions are analogues to secured loans. If one is treated more favorably than the other in bankruptcy, one can expect creditors to adopt the more favorable mode.

It is possible that the differential treatment provided under sections 1129 and 1325 cramdowns on the one hand, and under section 365 (no cramdown) on the other, will send creditors scurrying for section 365 treatment. Doubtless this will produce a new crop of cases on that tedious question: is this document a true lease or merely a disguised security agreement? It will also bring litigation on the status of consignments in bankruptcy,

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[88] Equipment leasing is now so widespread that it is unlikely any sensible creditor relies upon his debtor's possession of equipment as proof of ownership without first making some inquiries concerning the extent of the debtor's ownership interest. Although consignment has become more common, and it may sometimes be possible to charge a creditor with knowledge of the consignment, the potential for being misled by appearances is still greater than in equipment leasing. *See* R. SPEIDEL, R. SUMMERS & J. WHITE, COMMERCIAL AND CONSUMER LAW 254-57 (3d ed. 1981).

and it may stimulate the imagination of creditors' lawyers to devise forms of ownership that are not leases, nor consignments, nor security agreements.

C. Purchasing Assets of the Debtor, Factoring

A second proposal that has recently been made to deprive the bankruptcy court of jurisdiction and to free assets from the automatic stay is to adopt the ancient practice of factoring.[89] Under a classical factoring arrangement, the creditor purchases accounts receivable without recourse, takes possession of all the documents, and makes collection directly from the account debtors. If he does all of those acts and files a financing statement as well, he has probably escaped the jurisdiction of the bankruptcy court. He has avoided any possibility that the trustee in bankruptcy will be able to enjoy any appreciation in the value of the collateral, and he has freed himself from the stay in section 362.

Attempts at factoring that preserve some elements of recourse against the debtor are certain to face challenges by debtors in possession and by trustees.[90] To the extent that the purchaser of accounts receivable retains a recourse right against the debtor, the transaction takes on more of the colors of a loan and less those of an outright purchase of specific assets. If factoring is widely adopted in an attempt to avoid the automatic stay and cramdown, we will see litigation about what "loan" elements can be present in a factoring agreement and yet have it qualify as a true factoring arrangement.

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[89] *See* Koch, *Bankruptcy Planning for the Secured Lender*, 99 BANKING L.J. 788, 792-96 (1982); *cf.* Major's Furniture Mart v. Castle Credit Corp., 602 F.2d 538, 540 (3d Cir. 1979) (court will look behind language of transaction to decide whether legal rights and economic consequences of agreement are more like those of a sale or a financing transaction).

[90] A court will have to consider whether an agreement is a true sale of accounts or only a secured loan, a problem not unlike that faced with purported leases. Conceivably, a court may rule that an assignor's retention of some legal or equitable interest in the assigned accounts makes the transaction a secured loan. *See, e.g.*, Major's Furniture Mart v. Castle Credit Corp., 602 F.2d 538 (3d Cir. 1979) (transfer of customer receivables by debtor found to be financing transaction); Credit Alliance Corp. v. Nixon Machinery Co. (*In re* Nixon Machinery Co.), 6 Bankr. 847, 851 (Bankr. E.D. Tenn. 1980) (assignment of accounts with recourse declared security transaction); *see also* 11 U.S.C. § 541(d) (Supp. III 1979) and *infra* note 91.

There will also be litigation about application of the stay in certain circumstances where the disposal of the account is not complete. Assume, for example, that a creditor purchases accounts receivable and has no recourse against the debtor, but he does not notify the account debtors. Assume that he executes an agreement with the debtor to collect the accounts on his behalf. Under this arrangement, presumably the debtor continues to collect the accounts and periodically pays the proceeds over to the creditor. Will the automatic stay prohibit such payment? It would seem so. In that circumstance, will the automatic stay prohibit the creditor from himself notifying the account debtors and making collections after the petition? That is less clear.[91]

Assuming that Congress has the constitutional power to do so,[92] it seems highly unlikely that Congress has the will to enact

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[91] Section 541(d) of the Bankruptcy Code arguably addresses this point and renders the factored accounts not part of the estate. *See* 11 U.S.C. § 541(d) (Supp. III 1979). By that section, Congress intended to permit a mortgagee to sell shares of his mortgages to third parties and continue to service them. It is intended to grant the purchasers of such mortgage interests priority over the trustee in bankruptcy of the seller. The case is precisely analogous to the one posed in the text. Although subsection (d) was stimulated by the mortgage question, the language of the subsection would apply to other factoring arrangements as well.

[92] Congressional response to widespread factoring and leasing might take various forms. Initially, Congress might simply amend § 365 to provide for the treatment of leases under § 1129. Conceivably, Congress could enact a law that would purport to override contrary state rules. Such a law might provide that at least in bankruptcy, transactions framed as "factoring" or "leases" under state law be regarded as security transactions. If such a law applied only to transactions entered into after its effective date, it would merely constitute a federal redefinition of the property rights of the persons who entered into those transactions.

Consider some of the constitutional objections that would certainly be asserted if Congress retroactively attempted to change the rights of lessors and factors. The most obvious challenge is one under the taking clause of the 5th Amendment. Justice Rehnquist's opinion in United States v. Security Industrial Bank, 103 S. Ct. 407 (1982) suggests that at least the conservative wing of the Supreme Court would be receptive to such arguments.

Note that if the legislation were cast in the form, not of redefining the private property rights that attach to a certain status, but rather that of redefining the form necessary to achieve that status, the challenge would be more difficult. For example, Congress might enact an amendment to the Bankruptcy Code that would state that a lease or factoring transaction would have to have certain attributes in order to be recognized as a true factoring agreement under the Bankruptcy Code. Even though it might be virtually impossible to achieve that status, the Congressional subterfuge would make the challenge much more difficult. A similar challenge might be based on the due process clause of the 5th Amendment. Even if Congress were quite unsubtle and simply purported to make a

legislation to deprive the creditor of the power either of exercising a lessor's rights under the section above or of factoring, as provided in the previous paragraphs. To prohibit those transactions would require legislation that not only changes the substantive law concerning ownership interests, but also overrides the explicit agreement of the debtor and creditor. Surely Congress is unwilling to prohibit the debtor, even one on the verge of bankruptcy, from making good faith disposals of his property. Failing such a general prohibition, how could Congress prohibit such a debtor from selling his accounts to another creditor? I maintain that it would not do so. Moreover, Congress is unlikely to wish to call into question all transactions that occur during some short period prior to bankruptcy. To grant the bankruptcy court the power to upset all such transactions, including those

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retroactive change in the rights of factors and lessors, some maintain that there would be no violation of the 5th Amendment. *See* Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the 5th Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983).

If Congress made such legislation only prospective, the constitutional challenge would be more difficult. By hypothesis the "taking clause" requires that the injured party have "something" to be taken. If Congress simply were to define the legal rights attached to one who signed a lease or factoring agreement, and if one assumes that it had the power to do so either under the commerce or the bankruptcy clauses, no taking would have occurred. The congressional action in this case would be no different from the routine and prospective redefinition of private property rights in a variety of circumstances by state legislatures. An example of such redefinition or codification can be found in U.C.C. § 2-326 (1972). There the UCC defines the rights that attach to a consignment. An examination of that section will disclose that those rights are likely to be quite different from ones that might be asserted in the consignment document itself.

Depending upon the form of the legislation, it is conceivable that one could challenge it for denying equal protection. Assume, for example, that the bankruptcy laws were to recognize the debtor's pre-bankruptcy sale of any of its assets (putting aside the question of voidable preferences and fraudulent advances) to anybody except sales to those who somehow were defined as "financing agencies." Could not the financing agencies argue that the abrogation of their rights, acquired in transactions for fair value and in good faith, constituted a denial of equal protection if an identical sale to a non-financing agency would have been recognized and could not have been challenged in bankruptcy?

A more significant inhibition on congressional action might be found here in its respect of states' prerogatives. Of course, nearly all bankruptcy law somehow modifies rights of private ownership under state law in a variety of ways. An outright redefinition, however, of the private rights of ownership of one who had bought an asset from a bankrupt, or had made a bailment of an asset to a bankrupt, might even make a congressman blush.

for current consideration and in good faith, would merely accelerate the debtor's slide into bankruptcy, for the debtor would find no one willing to deal with him in the face of the slightest rumor of impending bankruptcy.

Conceivably, Congress could enact legislation that would do the same thing to a lessor's interest as arguably has been done to a consignor's interest by section 2-326. Congress, however, has not yet done so; sections 1129 and 365 fall well short of such action. Moreover, for Congress to do so would be a substantial intrusion into an area traditionally reserved to the states concerning the property rights of private parties.

In conclusion, it appears that factoring, leasing, and possibly consignment, can be used by secured creditors to avoid some of the more objectionable aspects of the cramdown, and possibly even of the automatic stay. Accordingly, we can expect to see an increase in their use and the rise of litigation concerning the legal rights of factors, lessors, and consignors in bankruptcy.

D. Taking Greater Security

An obvious response to any reduction in a secured creditor's rights is to take more security. One can expect, therefore, that the first secured creditor in line will ask for a security interest in a larger number of assets than he might have otherwise. If one assumes that all of the assets of a typical bankrupt are subject to some security interest at the time the petition is filed, the consequence of a first secured creditor taking a larger share simply will be to shift the loss from one party to another. Such a shift will not substantially change the position of the debtor, unless it means that other creditors will not lend at all when there are no assets to secure them. If that is so, the potential pool of creditors may become smaller than would otherwise be the case. That consequence is problematical.

E. Guaranties

Another obvious response to adversity on the part of secured creditors is to insist on guaranties. In the consumer context these are likely to be from family members; in the context of the small business they are likely to take the form of personal

guaranties by the principals. With larger businesses they are likely to be found in the guaranties of parent or subsidiary corporations.

Except in Chapter 13 cases, where section 1301 stays collection efforts against sureties of consumer debts, the filing of a petition by the principal does not stay collection efforts against guarantors.[93] Thus, in Chapter 11 and Chapter 7 proceedings, one can expect secured creditors to turn to those who have guaranteed the debts.

F. Higher Rates

The fourth and most obvious response to reduction in a secured creditor's rights is likely to be an attempt to increase charges. At least in the business context, where usury laws do not limit the rates of charge, this is an obvious and almost certain response to a decline in the value of security. Conceivably such higher rates may be offset by lower rates on the part of unsecured creditors who may now enjoy a share of the assets that formerly would have gone to the secured creditors. That, of course, will not be true in the consumer context where the debtor himself may enjoy that element of value, as for example, when he buys the Corvette out of the estate for $8,000 instead of having to pay $15,000 to the secured creditor.

G. Shifting the Risk to the Taxpayer; Guaranteed Loans and Other State Assistance

Most of the responses discussed above are short-term and

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[93] Bankruptcy Reform Act of 1978, §§ 524(c), 1301, 11 U.S.C. §§ 524(c), 1301 (Supp. V 1981). *See generally* H. MILLER & M. COOK, A PRACTICAL GUIDE TO THE BANKRUPTCY REFORM ACT 421-23 (1979). Testimony before the Commission on the Bankruptcy Laws of the United States indicated that creditors frequently required co-signatures on consumer loans by the debtor's friends or relatives who generally were unaware of the legal significance of their acts. In the belief that this practice unjustifiably deprived consumer debtors of the full benefit of their discharge and upon finding the problem particularly serious in Chapter XIII cases, the drafters of the Bankruptcy Code adopted a special automatic stay applicable in Chapter 13 to creditor efforts to collect consumer debts from individuals liable on a debt with the debtor. *See* 5 COLLIER ON BANKRUPTCY ¶ 1301.01[1] (rev. 15th ed. 1983); P. MURPHY, CREDITORS' RIGHTS IN BANKRUPTCY § 18.02 (1980); Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. MICH. J. L. REF. 3, 49-61 (1978).

individualistic. If creditors' rights are sufficiently impaired that creditors choose not to make certain loans, and further, if those loans are perceived by Congress to be of sufficient social value,[94] we may expect to see new forms of federal loan guarantees of the kind that exist today. Currently there are over 160 federal loan guaranty programs.[95] These are designed to benefit the veteran, home buyer, farmer, student, synthetic fuel manufacturer, car manufacturer, and even small airlines. For the same reason that private parties often improvidently grant guaranties, Congress itself has been willing to guarantee many forms of loans. At the outset a guaranty looks free — one simply puts his name behind another — and if everything goes as expected and planned, he is never called upon to pay a penny. Indeed, the guarantor may charge a fee for the use of his name and thus make money by giving his guaranty.

It is difficult to predict when and where Congress might be moved to guarantee new types of loans. The frequent enactment of such legislation, however, suggests that we have not seen the last loan that Congress will guarantee. One can visualize a scenario under which creditor responses would reduce the level of credit for certain kinds of activities below that deemed acceptable to Congress, and in which Congress would step in. Consider the following scenario. Assume, for example, credit unions, banks, and other traditional automobile lenders find that they cannot lend money profitably against automobiles in part because of the large number of bankruptcies in which the owners of automobiles retain the car, do not reaffirm, and discharge the debt by a payment much lower than the outstanding debt. Assume that these lenders cease making car loans and turn instead to treasury bills or business borrowers. Conceivably some who might be willing to make car loans find that they are unable to do so profitably because the usury limit prohibits them from acquiring a market rate.[96] How might Congress respond to a pro-

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[94] A more cynical analysis might lead one to ask whether those seeking loans have sufficient political influence.

[95] *See* Comment, *The Choateness Doctrine and the Federal Loan Programs—A Plea for Federal Legislation*, 33 ME. L. REV. 269, 269 (1981).

[96] A number of empirical studies have found that when the market rate of interest exceeds the usury limit, the result is a decrease in the amount of available credit. *See*

posal for federal guarantees? A Congressman voting for such loans could simultaneously court the automobile industry, the UAW, and hundreds of thousands of prospective car buyers. Moreover, a guaranty does not "cost" anything, and the whole program can be portrayed as cost-free.

The automobile scenario may be farfetched. It is not farfetched, however, to suggest the enactment of government guarantees in arenas now unforeseen where creditors have withdrawn and when Congress perceives a need.

Conclusion

In concluding, I apologize for the poverty of my imagination. Several of the suggestions about creditor behavior that I have made could have been devised by a first-year law student. Surely the creditor's lawyer will propose much more innovative and elegant devices than I have suggested here.

I apologize too, for not addressing what is the single most interesting question here; namely, whether society will be benefited by the net accomodations that will arise from the change in the law offset by the creditors' responses. It is conceivable that the methods adopted by the creditors as substitutes, such as leasing and factoring, will be less efficient means to accomplish the same goals as the taking and perfecting of a security interest in personal property.

If, as I suggest, Congress is moved to guarantee certain consumer and business loans, it seems inevitable that we will have produced an inefficient response. The recent history with the student loans has shown how horribly costly such a system can be.[97] Although the abuses and difficulties have not been as obvi-

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Note, *Usury Legislation—Its Effects on the Economy and Proposal for Reform*, 33 Vand. L. Rev. 199, 212-18 (1980).

[97] At least initially, in that system there was no significant motivation on the part of the universities to make collection. Default rates soared far above the rates that would have been experienced or tolerated by any private lender. *See generally* Hunter, *Collecting Defaulted Student Loans: How Much Diligence is Due?*, 9 J.C. & U.L. 149 (1982-83); *Skipping Out on Alma Mater: Some Problems Involving the Collection of Student Loans*, 15 Colum. J.L. & Soc. Probs. 317 (1980); Doyle, *The Federal Student Loan Mess*, Wall St. J., May 19, 1982, at 28, col. 4. According to the latest available figures, the default rate (number of loans in default as a percent of cumulative matured loans) for 1979 was 16 percent for National Direct Student Loans and 11.5 percent for Guaranteed

ous in other areas, one suspects that a careful examination of the Small Business Administration, or of a variety of the other guaranty programs, might reveal similar, if less dramatic, inefficiencies. Of course, that is not to say that Congress was wrong in establishing these programs. At least if there was no other more efficient method of accomplishing the Congressional goal, perhaps the cost was worth it.

If one considers the simplicity of acquiring and perfecting a security interest under Article 9, and notes how widely the Article 9 security interest has been accepted and applied,[98] it seems unlikely that creditors regard factoring and other such ancient substitutes to be as efficient. If the enactment of the Bankruptcy Reform Act of 1978 and a series of other events occurring between 1965 and 1980 have substantially diminished the rights of personal property secured creditors, history tells us that those creditors will seek to regain their lost ground in a variety of ways. The principal consequence of the erosion of creditors' rights may be to drive creditors to the use of less efficient means of acquiring the same results, or to transfer the burden of increased cost to the taxpayers through guaranty programs. The question for scholars, for courts and ultimately for legislatures is whether society will have profited from the net changes when matters once again come into equilibrium.

Student Loans. The default rate for Guaranteed Student Loans rose to 12.5 percent in 1980. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1981 163 (102d ed. 1981). By comparison, the delinquency rate—number of loans delinquent 30 days or more as a percentage of total installment loans outstanding—on bank installment loans in 1979 was 2.93 percent. *Id.* at 519.

[98] *See supra* notes 20 and 21.

THE LAWYER AS HERO

*James L. Robertson**

I. The Beginnings of the Idea**

In January of 1983, I assumed the office of Justice of the Supreme Court of Mississippi. This brought to a close more than 17 years of lawyering all over the state of Mississippi.

In the past several months, I have often reflected on my experiences as a lawyer.[1] There were many failures. Happily, a few successes dotted the way. There were many ideals and dreams, glimpsed though not reached.[2] I have experienced warm friendship and fierce adversary from great lawyers. I have learned much and have tried to share much of what I have learned.

Eighteen years ago I received my law degree. I was admitted to the bar shortly thereafter. I joined what I considered then and now the noblest of the professions. Many, if not most, of the heroes of our republic have been lawyers. Alexis de Tocqueville observed: "In America . . . lawyers . . . form the highest politi-

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* Justice, Supreme Court of Mississippi. B.A., 1962, University of Mississippi; J.D., 1965, Harvard University. This article is an elaboration upon remarks made by Justice Robertson to the Jackson Young Lawyers Association on June 17, 1983, and an address to the graduating class of the University of Mississippi School of Law on August 9, 1983.

** If there is any one lawyer whose professional life and character have inspired the views I express here, it is Roy D. Campbell, Jr. of Greenville, Mississippi, who has been the Lou Gehrig of Mississippi lawyers.

[1] The reader will notice in the pages that follow that I have a foot in each of two camps. My lawyering days ended January 17, 1983; yet it is difficult not to think of myself as a lawyer. I speak here to lawyers as one who hopes he will be able to avoid one of the sins of which judges are most often accused—that of having forgotten what it was like to be a lawyer.

[2] Much of what I say in the pages that follow reflects perceived ideals about lawyers. Lest anyone suspect a pretense that is neither real nor intended, I wish to confess and emphasize my own shortcomings. I am painfully aware of the many irretrievable occasions when I faced the opportunity and challenge to lawyer heroically and fell short. I rely for the validity of the views I present here upon my observations of many lawyers over the past eighteen years, and upon having seen more than just a few on more than just a few occasions lawyer heroically.

cal class and most cultivated circle of society."[3] I nevertheless was aware that the lawyer had not always been universally loved. Negative public opinion of lawyers certainly existed in 1965 when I was admitted to the bar.

In the 18 years that have since passed, I have seen many changes in our profession, not all of which I like. My concern today is that the average lawyer is not what he[4] ought to be. He almost seems afraid to become what he ought—too much might be demanded. He decides all too readily that he and his firm should limit their practice to civil matters and then only certain "desirable" civil matters. He has come to accept, happily or not, the notion that the practice of law is a business first and that all else is secondary. The spirit of the law, as the foundation for our democratic order, seems of little concern to the average lawyer. Not surprisingly, at least in my perception, the average citizen holds the average lawyer in even lower esteem today than 18 years ago.

To be sure, the lawyer occupies a unique office in society. That office requires that we be prepared to give every fiber of our being, that we summon our every resource, in the cause of our clients. We go to lengths for our clients beyond what we would for ourselves. We demand of society that we be exempted from rules applicable to all others. The lawyer "has many privileges and possesses power not accorded others."[5] We expect no opprobrium when we advocate a cause in which we do not believe.

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[3] DE TOCQUEVILLE, 2 DEMOCRACY IN AMERICA 184-85 (2d ed. 1836).

[4] Throughout, I use the pronouns "he," "his," and "him" when referring to lawyers. I want to emphasize here that I well know that there are many women who are lawyers today. I am delighted that this is so, and that the number of female lawyers is increasing each year. I am very much aware that many female lawyers come a lot closer to living up to their responsibilities as lawyer "heroes" than do many male lawyers. I have nevertheless used the masculine pronouns here. "He or she" would have been unnecessarily awkward. The impersonal "it," of course, would have been downright silly.

Invoking the lawyer's right to define his terms, I declare that when used hereafter "he" *always* means "he or she," "his" *always* means "his or her," "him" *always* means "him or her," "himself" *always* means "himself or herself," and, of course, "hero" *always* means "hero or heroine." The few times I use "man" I intend to refer to "man and woman," or, as I prefer, "mankind."

[5] Petition for Disbarment of J.R. Poole, 222 Miss. 678, 686, 76 So. 2d 850, 853 (1955). *Cf. infra* note 17 (commentary by Justice Gillespie).

This exemption we claim has its *quid pro quo*. Our unique office also requires sacrifices.

The low esteem in which lawyers are held is much of their own making. While I support efforts to educate and inform the citizenry regarding the role and function of the lawyer,[6] I suspect that our focus should be on ourselves. Are we doing what we ought to be doing? Are we true to the heritage and noblest traditions of our profession? Do we understand the trade-offs that are the *quid pro quo* of our exercise of the special role of the lawyer? Do *we* truly understand our office in society and do we serve well in that office?

It is my purpose to discuss these matters with you. I wish to share the insights and ideas that have been generated by my 18 years at the bar. That experience has included representing bank presidents and bank robbers, accused rapists and taxpayers. I have been lucky enough to have the opportunity to do a little of every kind of law practice — except perhaps patent law. Experience suggests that the role I describe here is both practicable and necessary, both for the lawyer and those whose needs he serves.

I know about secretaries' salaries, word processors, computerized legal research, and all of the other modern office equipment so necessary and yet so expensive. I know about the expense of maintaining an adequate law library, about paying office rent and utilities. I insist that nothing I am about to say in any way ignores these realities.

It is the lawyer's extreme good fortune that, even when he hitches his wagon to the star I see, in general and over the years, he can make a more than comfortable living for himself and his family. Because this is so, because I know that it is so from observed experience, I, with no little temerity, wish to share here a view of the lawyer's role in our society that I hope you will accept.[7]

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[6] The image of attorneys and public credibility of the legal profession are among the most important concerns of the profession, according to a recent Law Poll survey. *Lawyers Concerned About Their Image and Credibility*, 69 A.B.A.J. 440 (1983).

[7] Views not at all dissimilar to those expressed here have been expressed by Eugene C. Gerhart in *These Unloved Men*, 50 Miss. L.J. 513 (1979). I commend to the reader Mr. Gerhart's thoughtful comments.

Out of my experience I have evolved the firm belief that the lawyer can, and ought to become one of society's heroes.

II. The Role of the Lawyer Idealized

Before getting into the more formal exposition of my concept of the "lawyer as hero," I think a few general thoughts about the role I have seen lawyers play in our society may be well to consider. The lawyer's role, to be sure, has been widely debated and variously played. It has been misunderstood even within our profession. Yet there are a few familiar threads.

To many, the lawyer is a mere extension of the will of the client. The client wishes to pursue certain ends but is without technical, legal skills. The lawyer provides those skills. He is a mere conduit through which the client pursues his ends.[8] The lawyer at once is both highly partisan and completely neutral. He aggressively pursues the ends of his client, yet he remains personally indifferent to those ends.

I see the lawyer as combining into one the best attributes of the counsellor, the architect, and the advocate.

As a counsellor, the lawyer's advice is his most valued commodity, his most desired service. His capacity to form sound and insightful judgments quickly and accurately is his most needed skill, a *sine qua non* for effective service. His counselling focuses on the likely effect and consequences of both past and contemplated actions. One of his fundamental tasks is prediction. Because he must become totally informed concerning his client's business, while remaining detached from it, the lawyer is frequently called upon to render advice and counsel beyond that strictly legal in nature. He has appropriately been called the "wise counsellor."[9] Beyond that, he is called upon daily to invade the territory of the psychologist and the minister. He is obliged by his role not to hesitate. He is indeed a friend, often

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[8] Many other analogies have been offered. *See generally* Simon, *The Ideology of Advocacy: Procedural Justice And Professional Ethics*, 1978 WIS. L. REV. 29, 39, 61, 91 (1978) (lawyer as "champion," "para-bureaucrat," and "acolyte"). I find particularly appealing my old professor Charles Fried's analogy of "the lawyer as friend." Fried, *The Lawyer as Friend: The Moral Foundations of the Lawyer-Client Relation*, 85 YALE L.J. 1060, 1065-72 (1975-76).

[9] Chayes, *The Lawyer and the Corporation*, 34 HARV. L. SCH. BULL. 6, 6 (1983).

one's best friend, occasionally one's only friend.

Law is one of the most creative forces in our society.[10] But, it is not self-executing. It needs designers with vision and imagination. It needs architects. As an architect, the lawyer receives daily demands that he help people structure their businesses, their estates, their socio-economic relationships with their fellow citizens. He helps repair damaged structures and, when necessary, dismantles them. Frequently, more happily, he helps build new ones. The lawyer organizes corporations, drafts contracts and wills, creates trusts, and in dozens of other ways provides legal structures through which people protect their property and pursue their dreams.[11]

Finally, I see the lawyer as an advocate. He speaks for and in the interest of his client. He does this in the planning room, at the bargaining table, and in the courtroom. He seizes every fair advantage available to his client. And when his client is on the ropes, the lawyer, standing alone if need be, is that one person who, in the interest of his client, skillfully defies the state, the opposing litigant, or whoever threatens. The lawyer is prepared to stand against the forces of hell though others see that as his client's just desert. He assures all adversaries, in the vernacular of the streets, "You may get my client but you've got to come through me first."

Before I became a lawyer, I thought of each living being as entitled to at least one other person who accepts him, who loves him, irrevocably and without reservation—who will go through hell for him if need be. I have come to realize that this describes the lawyer's relationship with his client. To the full extent and duration of that relationship, this—and nothing less—is the role the lawyer is called upon to play.

I am awed by the analogy to the concept of the Advocate in

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[10] A point needs emphasis here. Many think of law first and foremost as a source of order. Punishments are imposed and compensation is awarded when rules securing order are breached. Equally as important, however, is the law's creative function. Law facilitates the expansion of wealth and its fair division. It enhances liberties. It enables us, as individuals, and as a society, to do things we could not do without it.

[11] It is an observable anomaly that a lawyer is often far more careful and meticulous in the structuring of his clients' affairs than of his own.

Christian theology.[12] The structure assumes that each person is a miserable sinner wholly unworthy by any standard, one whose just desert is eternal damnation. The Advocate accepts that sinner wholly without reservation and petitions for his salvation. The ultimate act of advocacy, of course, was on the cross. Lawyers as advocates are called upon to take up the cross of their clients. Many shrink from this duty—perhaps "rationalize" is a better word than "shrink." Others try and fail.[13] It is inescapably a part of the lawyer's calling.

All of this is a far cry from the way most people think of lawyers. It is a far cry from the way many lawyers think of themselves. Today's lawyer is seen as brash and arrogant. His fees are too high.[14] Most think he is unprincipled, that he will do anything to win for his client. Few understand how a lawyer can ethically represent someone he "knows is guilty." All of this is periodically reflected in public opinion polls in which lawyers rank slightly lower than politicians.

People who otherwise have no use for Shakespeare delight at the obscure line, "The first thing we do, let's kill all the lawyers."[15] Yet this line from Shakespeare can do much for the lawyer's cause. Uncharacteristically, lawyers have failed to seize upon this slip by their adversaries. Through close examination of this oft-quoted line, one may demonstrate a context that should exalt, not denigrate, the lawyer.

If we want to destroy personal liberty, if, as 1984 approaches, we want to de-individualize and dehumanize the peo-

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[12] *See* BARCLAY, THE LETTERS OF JOHN AND JUDE 42-45 (2d ed. 1960) (theological exposition of 1 *John* 2:1 characterizing the Christ as "our Advocate with the Father").

[13] In the words of President Theodore Roosevelt:

> It is not the critic who counts, not the man who points out how the strong man stumbled, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena; whose face is marred by dust and sweat and blood; who strives valiantly; who errs and comes short again and again; who knows the great devotions, and spends himself in a worthy cause, who at the best knows in the end the triumph of high achievement; and who at the worst, if he fails, at least fails while daring greatly; so that his place shall never be with those cold and timid souls who know neither victory nor defeat.

15 THE WORKS OF THEODORE ROOSEVELT 354 (Scribner mem. ed. 1923-1926).

[14] *See generally* Green, *The Gross Legal Product: "How Much Justice Can You Afford?"*, in VERDICTS ON LAWYERS 63-70 (1976).

[15] W. SHAKESPEARE, 2 HENRY VI, act IV, scene ii (1591).

ple of this republic, then the first thing we do, let's kill all the lawyers. For in this land, where we enjoy the fruits of scientific and technological advance, economic and material well-being, in which we live longer than ever before, it is the role of the lawyer to help make our life worthwhile. The lawyer protects our autonomy, our individuality, our right to be different all the way to the point where we begin to interfere with similar rights in others.[16] As much as is the case with the poet or the artist whose role it is to probe and lift the spirit of mankind, it is the role of the lawyer to assure that our society remains sufficiently free that the poet and the artist can do his creative work.

III. The Role of the Lawyer and the *Quid Pro Quo*: Herein of the Potential for Villainy

It is my thesis that the circumstances in which the lawyer finds himself, the role he is called upon to play, provide him a unique opportunity to become one of society's heroes.[17] I have known lawyers who have practiced their profession as they ought but who seemingly have been unaware of the heroic nature of their works—though modesty is seldom the most noticed of the lawyer's personality traits. Yet, as our circumstances make for special opportunities for heroic service, they make it equally easy for us to slide into villainy.[18]

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[16] I refer here to the first principle of justice as articulated by John Rawls. Rawls, A Theory of Justice 60 (1971). When an individual has been denied that maximum amount of basic liberty consistent with equal liberty in others, the lawyer's job begins. When this basic liberty is denied, whether by arbitrary action of the constabulary or due enactment of the legislature, our profession by the nature of its calling is enjoined from silence.

[17] I think this is close to what the late Justice Gillespie (later Chief Justice) had in mind when he wrote, in more traditional terminology:

> The attorney occupies a unique place in our society; he has great opportunity for useful and honorable service, with an equally great responsibility to maintain the highest standard of professional conduct; he is entrusted with the problems, money, and property of all manner of people, the ignorant and helpless, the rich and the poor; he has many privileges and possesses power not accorded others; the responsibility of administering justice is largely in his hands; his conduct involves the integrity of the courts of which he is an officer, and the good name of the legal profession; . . . .

In re Poole, 222 Miss. 678, 686, 76 So. 2d 850, 853 (1955).

[18] My thesis is based on observation and experience. I make no pretense that what

I am sensitive to the changing role of the lawyer in corporate America.[19] Still, I see house counsel or special purpose counsel as having the same opportunities for heroism or villainy as I see for lawyers generally. In any context in which a lawyer is called upon to act as a counselor, an architect, or an advocate, the opportunities for heroism or villainy are wholly available—and inescapable.

The part of the lawyer's job others least understand is that which requires that he argue a position he may personally find distasteful or without merit. The lawyer presents his client's case in its most favorable light. He invokes every substantive or procedural right that might conceivably aid his client. Usually, he is paid for doing this. The lawyer, for a fee, devotes his every energy and resource toward winning for his client. For this very reason we are regarded as hired guns, forensic prostitutes, and worse.

This, of course, assumes that we are behaving honorably (as *we* define "honorably") as advocates for our clients. Is it any wonder that the public reacts when we openly acknowledge that our foremost goal is to turn a profit? We spend more time at-

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is presented here is a rationally defensible view of the role of the lawyer against the backdrop of some jurisprudential theology. Lawyers, like all others, are trapped within the ambiguities of life. *Cf.* TILLICH, 3 SYSTEMATIC THEOLOGY 162-282 (1963). Their relationships with their clients are filled with ambiguities that it is foolish to decry.

For example, in the positivist view, the lawyer is supposed to advise his client regarding the client's ends. On the one hand, he is strictly forbidden to subvert in any way his client's autonomy. On the other hand, the lawyer has an infinitely superior position by virtue of his knowledge, training and experience. His client does rely on him, depending, to be sure, on the client's level of sophistication and force of personality. Beyond that, the lawyer will inevitably refer to his own personal ends, his own middle class American values, when advising his client. On occasion, the lawyer is presented with the task of saving the client from his own folly.

I find of little ultimate value attempts to critique the conduct of lawyers by reference to rational consistency with one school of jurisprudential thought or another. *See, e.g.*, Simon, *supra* note 8, at 39-42, 62-67, 92-94 (different schools of jurisprudence). Such efforts ignore the observed, and, I suggest, inevitable ambiguities of the lawyer's professional life—the tension between the preservation of the individuality and autonomy of the client, on the one hand, and the constant opportunity and occasional necessity of subverting that autonomy, on the other. How well the lawyer balances these interests and functions within that tension, not whether he adheres to a rationally consistent jurisprudence, should be our concern.

[19] *See* Chayes, *The Lawyer and the Corporation*, 34 HARV. L. SCH. BULL. 6, 6-8 (1983) ("the changing profession").

tending seminars about the economics of the practice of law than we do nourishing and drinking from the spirit of our law. We spend more time studying law office management than we do serving persons whose lives stand to be wrecked if there is no lawyer to aid them. The public begins to see ambulance chasers. It sees greedy mercenaries who arrogantly thwart the public interest, not out of any idealistic zeal to protect the interests of a client but to make a buck. It sees manufactured lawsuits in which files are needlessly milked for every billable hour possible and in which a settlement is reached not that dissimilar to what could have been accomplished before the lawyers were hired.

Arguing a position you do not believe in is bad enough. Doing it to assure the integrity of the process and fairness to the client likewise is difficult for the layman to understand. But when all of this is done for the sole and only purpose of earning a fee, and when the fee is seen as the be-all and end-all of life, the lawyer's *raison d'etre*, the public's contempt is as deserved as it is real.

The lawyer claims for himself special exemptions from rules of behavior applicable to everyone else. He claims the privilege, indeed the responsibility, of arguing for causes in which he personally does not believe. He claims exemption from societal opprobrium when he discredits a witness he may personally suspect to be truthful.[20] He claims the right with impunity to assist clients in organizing and structuring industrial and commercial ventures, though he reasonably foresees a substantial adverse impact on the consumer or the environment. He gives his all for his client without vouching for his client's ends.

I wholly defend this view of what a lawyer ought to do. The nature of his role and function in society is such that the lawyer must have these exemptions. They are valid. Society must honor these claims. Yet, in my view, there is a *quid pro quo*.

Because the lawyer claims exemptions from otherwise valid and applicable societal norms, he must forfeit certain privileges wholly and honorably available to nonlawyers. Foremost among those things the lawyer must forfeit is the privilege of structur-

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[20] Freedman, *Professional Responsibility of the Criminal Defense Lawyer: The Three Hardest Questions*, 64 MICH. L. REV. 1469, 1469 (1966).

ing his practice so that it serves first his self-interest. And within this general forfeiture, he gives up any notion of running his office to maximize his profits. For the right to call himself a lawyer, he simply must forego the prerogative to consider his practice a business first and foremost.

I do not question that there is an economic side to the practice of law, and it is important. The overhead must be paid. The lawyer must reasonably provide for himself and his family. But when the occasion demands, he simply must set aside his personal financial interests and do his duty.

The Bar has long accepted, and is ethically bound by, the premise that, on the priority scale, rendering legal services is first and collecting fees is second. The foremost Ethical Consideration in our Code of Professional Responsibility is "that every person in our society should have ready access to the independent professional services of a lawyer of integrity and competence."[21] "Every person" means every person without regard to economic or social standing. We recognize that a person of moderate means may be unable to pay a reasonable fee for complex or unusual legal problems he may confront.[22]

These persons, as well as the indigent, should be served. "*Every lawyer, regardless of professional prominence or professional workload*, should find time to participate in serving the disadvantaged."[23]

Closely related is the lawyer's heavy responsibility to accept representation of unpopular causes. "History is replete with instances of distinguished and sacrificial services by lawyers who have represented unpopular clients and causes. Regardless of his personal feelings, a lawyer should not decline representation because a client or a cause is unpopular or community reaction is adverse."[24]

Our Justice Armis Hawkins was speaking the truth when he recently reminded us: "Each generation of free men owes a debt of gratitude it can never repay to those courageous lawyers in

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[21] MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 1-1 (amended 1983).

[22] *Id.* EC 2-24.

[23] *Id.* EC 2-25 (emphasis added).

[24] *Id.* EC 2-27.

our history who have risked their livelihood, their liberty, and some even their lives in defending an unpopular cause, or an accused charged with a loathsome or heinous offense."[25]

I pray—and trust—that two, three, four generations hence, free men will gratefully repeat these words.

IV. The Five Fronts on Which the Legal Profession Is Obliged to Serve

When a person is admitted to the Bar and accepts a license to practice law, he assumes certain responsibilities. When that person takes his place among society's lawyers, he becomes obliged to the limit of his aptitude, energies and abilities to become active on five different fronts. To be sure, he may operate collectively, through law firm partnerships or through organized bar and other lawyer associations. Still each individual lawyer assumes the responsibility and obligation to assure that badly needed services are rendered in five major areas.

These five areas are:

(1) *Service to Clients.* Here, of course, is the lawyer's true *raison d'etre.* This service, to be sure, has an infinite variety of forms. It may include representation in litigation, civil or criminal. It may include representation and advocacy through alternative methods of dispute resolution. It may include planning, in which the creative powers within our law are brought to bear to enable the client to realize his aspirations or dreams. It always includes advice and consultation.

The types of clients lawyers represent vary greatly. An infinite variety of corporate organizations and other similar business organizations are in constant need of legal services. State and government lawyers represent the public interest. And there are private lawyers who are charged to act as private attorney generals. Lawyers represent classes — consumers, ethnic groups, and, occasionally, even "trees."[26] By far most fundamental, now

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[25] Johnson v. State, 416 So. 2d 383, 396 (Miss. 1982) (Hawkins, J., dissenting).

[26] *See* Stone, *Should Trees Have Standing? — Toward Legal Rights for Natural Objects,* 45 S. Cal. L. Rev. 450, 452-81, 501 (1972) (reprinted in Cover & Fiss, The Structure of Procedure 212-22 (1979)) (proposing that legal rights be given to "forests, oceans, rivers and other so-called 'natural objects' in the environment"). Stone's proposal

and forever, is the representation of the client.

(2) *Improvement of the Quality of Our Law and of the Legal Process.* The lawyer assumes a major responsibility to work for improvements in the quality of our law and the judicial and extra-judicial systems through which it is administered and vindicated.[27] Though by no means do they possess a monopoly on all wisdom regarding such matters, lawyers are in a unique position to identify unjust and outdated laws and to seek reforms. Even more is the lawyer in a position to know the strengths and weaknesses of our courts, their personnel, their structures and their procedures. Lawyers are likewise in a position to evaluate, compare, and contrast the relative merits of the judicial process, the administrative process, the legislative process, as well as arbitration and other alternative methods of dispute resolution. A lawyer, if he is true to his calling, contributes his insights and his time toward improvements in the quality of our law and our system.

(3) *Public Service.* Acceptance of the title "lawyer" carries with it a substantial obligation to render public service.[28] Opportunities to play a leadership role in one's community, state, and nation regularly devolve upon the lawyer. These too vary infinitely. Public service through political office, elective or appointive, is one major role the lawyer is called upon to take. Though not strictly legal in nature, this form of public service thrusts a lawyer into a major leadership role in the shaping of the public policy of society, as well as bringing good government to our citizenry. Leadership roles in charitable, civic, religious and other nonprofit organizations are very much in need of the abilities and services most lawyers have to offer.

(4) *Improvements in Quantity and Quality of Legal Services.* The lawyer has a major concern with the state of his profession. He is obliged to contribute his talents to the improve-

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was later adopted in theory in Sierra Club v. Morton, 405 U.S. 727, 741 (1972) (Douglas, J., dissenting).

[27] *See* MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 8-1 to -9 (amended 1983).

[28] *See* Coker, *President's Message,* Miss. Law., July-August 1982, at 5 (referring to speech by United States Court of Appeals Judge J. P. Coleman).

ment of the quality of services rendered by lawyers.[29] He must not tolerate incompetence or lack of diligence in himself or the members of his profession. He is concerned with the quality of our law schools and contributes his resources to them. He recognizes the absolute necessity for continuing legal education. He is a guardian of the ethics of the profession whose ranks he has elected to join. The law is no respecter of persons and the lawyer makes this a reality. Each lawyer has an ethical obligation to do his part to assure that quality representation, advice, and counsel are readily available to all who need it.[30]

(5) *Public Education in Law and the Legal Process.* The lawyer has a major educational responsibility.[31] For a variety of reasons, the vast majority of the citizens of this nation have little understanding or appreciation for the true nature of our law and our legal system. Even less do they understand or appreciate the role of the lawyer within that system. It is elementary that the law can never effectively achieve its potential if it is not understood. As we cannot enjoy the benefits of what the computer can do for us if we do not understand how to operate it, so it is with the law. And, though the assistance of nonlawyers is vital, lawyers have the major responsibility for public education. Legal rights and opportunities are often lost through ignorance. Lawyers have an obligation to educate persons to recognize these and to intelligently decide whether their exercise is appropriate. "Lawyers acting under proper auspices should encourage and participate in educational and public relations programs concerning our legal system with particular reference to legal problems that frequently arise."[32]

I would emphasize several things. First, these are not five neat, distinct, categories of service. There are no sharp division lines between and among them; rather, each shades into the others. When the lawyer performs his educational function, he is rendering a public service. When the lawyer performs his public service obligation by serving in the legislative branch of govern-

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[29] *See* MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 1-1 to -6, 2-1 to -33 (amended 1983).

[30] *Id.* EC 1-1.

[31] *Id.* EC 2-1 to -5.

[32] *Id.* EC 2-2.

ment, he frequently has the opportunity to improve the quality of law and our legal system. And when the lawyer represents his client as he ought, he almost always renders a public service, contributes to the quality of justice, and by his actions, educates.

Next, by no means do I intend to suggest that each lawyer should be equally active in each of these areas. There are not enough hours in the day. Lawyers have differing talents and abilities. They operate through different forms of voluntary associations. Lawyers as a group have an absolute nondelegable duty to be active in a major way on each of these five fronts. And each individual lawyer has the obligation to participate in each of these five areas to the limit of his abilities, energies, and resources.

By no means are these the only areas in which lawyers ought to be active. I do suggest, however, that these are the most important areas of lawyer activity. I further suggest that if we are not substantially effective in each of these areas, in the long run it will not make much difference what we do in other areas.

Finally, to return to my primary thesis, in my view what the lawyer ought to be doing in each of the five areas described above has a substantial heroic quality. If the lawyer truly does what he ought to in each of these areas over a substantial period of time, it is likely to occur to someone other than that lawyer that he has become one of society's heroes. By the same token, if one has been engaged in the practice of law for a substantial period of time and has not come to be thought of as a hero by at least a few of those who know him or know of him, that may well be an indictment of his entire career.[33]

V. The Idea of the Hero and of Heroic Strivings

Against this backdrop, one may begin to catch glimpses of my concept of the lawyer as hero. I believe that the role each lawyer inevitably is called upon to play in our society is heroic in nature. If the lawyer truly immerses himself in the calling of his

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[33] Here, to be sure, too much ought not to be expected. Lawyers, like prophets, often are without honor in their own country. *Cf. Luke* 4:24.

profession and if he is true to the heritage and tradition of that profession, if he claims and exercises the special privileges of the role of lawyer and cheerfully gives the *quid pro quo,* he becomes one of society's heroes.

Though I claim no adherence to any strict dictionary definition, the notion of a hero or of heroic strivings intuitively seems to have four components. First, the actor is striving against significant adversity. His task is quite difficult. There are substantial obstacles in the path toward achievement of his goals, and yet he does not waver or grow timid.

Second, there are the related elements of self-sacrifice and self-discipline. The hero puts others ahead of himself. He is single-minded when need be. He is selfless, even when confronted with the needs of others who are selfish. He accepts his role to serve others not only to the point of personal inconvenience but even to the point of great personal loss.

A person may strive against great adversity and at great risk of personal loss but, without more, his strivings may not be called heroic. This introduces the third, and perhaps most important, element of the concept of the hero: A striving toward noble ends. The hero pursues those ends identified by reference to the most fundamental values and beliefs of society.

Finally, the way in which one pursues noble ends must come under scrutiny. Noble ends do not justify ignoble means. The hero must bring to his task honesty, integrity, wisdom, fair dealings and good judgment.

In the next part of this discussion we will examine these four components of the idea of a hero. I hope to demonstrate that each has its special application to what lawyers do, or to what lawyers ought to do. For my part, I am left with the rather threatening conclusion that the lawyer's circumstances are such that he will inevitably become one of society's heroes, or one of its villains. I fear there is no in-between.

I will concentrate on what lawyers do as they represent clients. I will scrutinize what lawyers ought to be doing under the looking glass of each of the four components of our intuitive notion of the hero. That I concentrate on representation of clients should not be taken to exclude the other four areas in which lawyers ought to be active. Rather, I insist that what the lawyer

is called upon to do in each of the five areas described in Section IV above is heroic in nature. In each, the lawyer struggles against adversity and with sacrifice of self toward noble ends via honorable means.

VI. The Idea Applied[34]

A. Against Significant Adversity

In his role as representative, advocate and counselor of individual clients, the lawyer is confronted with substantial adversities of varying kinds. A few of these include:

(1) *David vs. Goliath.* As I have explained above, the lawyer is frequently the only person standing between his client and "the forces of hell." The lawyer's ingenuity and resourcefulness may be the only hope the client has to avoid financial ruin or substantial loss of liberty. In criminal proceedings, the state invariably possesses superior resources, ranging from investigative personnel to that identification as "the good guys," which so facilitates access to critical information. When one's adversary is the state or federal government, that adversary always possesses superior financial resources with which to conduct the litigation.[35]

In these David and Goliath situations, the lawyer must not cower. His adversary may (and often does) adopt a conscious

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[34] Let me be clear about what—and all—I do in this section. I provide in sketch form the bases of my idea that the circumstances in which lawyers work necessarily provide substantial opportunities for heroic service. I am testing an idea by what I have seen and thought.

I claim no logical symmetry. Indeed, I acknowledge overlap and occasional lack of precision—which, of course, are wholly irrelevant to what I am trying to say. Compare, for example, sections VI(B)(3) with VI(D)(4). Expressing related ideas in different words and different settings can reinforce a point.

Most important: I recognize that each component of my four general requisites for the idea is described in the most cursory fashion. Each in and of itself could form the basis of an entire article.

[35] A David and Goliath model is suggested above. This indeed is often the situation when the citizen is confronted by his government. I am by no means oblivious, however, to the fact that frequently the public prosecutor is David and the defendant is Goliath. I refer to cases involving white collar crime, organized crime and the like. In such circumstances it may be the defendant who has unlimited resources, able to assemble the best defense team of legal talent that money can buy. What the lawyer for the state does often is just as heroic as the defense.

strategy of making the litigation as costly as possible. One's client may well run out of money. In major litigation there are few adversities so debilitating or, when weathered, so exhilarating.

(2) *Public Opprobrium.* Another substantial adversity often confronted by the lawyer is public bias and prejudice occasionally reaching the point of hysteria. As often as not, the lawyer's client is in trouble or he would not need legal service. It is not uncommon for electronic and print media to sensationalize a case. Regrettably, there are some lawyers who try their cases in the newspaper. In any event, public perception of one's client and his cause is a substantial circumstance of adversity. The lawyer may be faced with the loss of other clients. The lawyer may similarly be faced with public opprobrium and criticism. The lawyer is guilty by association. Yet it is one of the most universally accepted and time-honored traditions of the profession that no lawyer should shrink from an engagement to serve a client whose cause is unpopular.[36] It is indeed the lawyer's responsibility to assure that, in spite of that unpopularity, the client's cause is judged under the law in a court of law and not in the court of public opinion. Still, as much as this is a part of the lawyer's calling, only the naive and uninitiated would imagine that performing this role is easy.

(3) *Dehumanization of the Client.* Confronting the forces that seek to dehumanize and de-individualize the person is another substantial adversity faced by the lawyer. It may well be, as science tells us, that each of us is nothing more than a mass of billions of subatomic particles held together by gravitational interaction and made lifelike by electromagnetic interaction. It may well be, according to the utilitarian calculus of government and of "the majority," that it is impractical and inefficient to allow people to exercise all of their legal rights. We live in a mass society. Economies of size and scale shape so much of our lives. In our zeal to avoid state-mandated collectivism we rush headlong toward that private collectivism of the corporation and the computer.

Our society is dominated by massive organizations—corporations, institutions, government. Within the organ-

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[36] *See* MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 2-27 (amended 1983).

ization is the inevitable tension between its impersonal drive for efficiency and its members' highly personal yearning for security—augmented always by a not inconsiderable dose of the Peter Principle. The organization is here to stay. Some lament this fact, others celebrate it—but none deny it. With a personal indifference the organization expends those within and without. Its capacity for dehumanization knows no limits.

In the face of all of this, it nevertheless remains the lawyer's charge to assure that his client's rights, his client's individuality, dignity, and worth not be sacrificed for the sake of the organization in the name of expediency. Knowing that there are, and always will be, imperfections within our legal system and judicial process, the lawyer must be ever diligent and fearless in assuring that his client's rights and aspirations are not sacrificed in the name of judicial efficiency.[37] Here indeed may be the most formidable adversity faced by the lawyer.

(4) *The Consequences of Mistake.* Another adversity faced by lawyers today is the consequences of mistake. Happily, though perhaps undeservedly, lawyers have traditionally enjoyed a certain immunity from the consequences of all except the most serious of their blunders. That is changing. Legal malpractice claims are being made, and some have merit.

Lawyers doing real estate title work, in spite of all care and diligence, occasionally miss an instrument in the chain of title. Every lawyer lives in dread of the telephone call from a fellow lawyer that begins, "Do you remember that title opinion you gave Mr. Smith back in 1973?" Lawyers occasionally let the statute of limitations run, miss a filing date, and the like. The consequences of these and other mistakes can be shattering.

Beyond legal malpractice is the familiar wolf cry of ineffective assistance of counsel in criminal cases. I have been shot at on this score[38] and have had the even less pleasant responsibility of shooting at others.[39]

Knowing well that today's lawyer may well be traversing a

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[37] *See* Read v. State, 430 So. 2d 832, 840-41 (Miss. 1983) (the priority of the "right" of persons over the "interests" of the state).

[38] Hill v. State, 388 So. 2d 143 (Miss. 1980).

[39] Bell v. Watkins, 692 F.2d 999, 1008-09 (5th Cir. 1983); Jones v. Thigpen, 555 F. Supp. 870, 878-79 (S.D. Miss. 1983).

mine field,[40] I nevertheless have little patience with those who practice law defensively, or worse, who altogether shrink from these tough cases. The twin hazards of legal malpractice and ineffective assistance claims come with the territory. Lawyers who worry about these matters are too late; these are matters that should have been thought about before one became a lawyer and accepted the responsibilities of that calling.

(5) *There Is Never Enough Time.* Another adversity of a practical nature is "time." Seemingly, there is never enough time to do as well as one ought. Though the public and particularly clients seldom understand this, the clock and the calendar are indeed major enemies of the lawyer. This adversity, of course, requires that the lawyer be realistic about the representations that ought to be undertaken. It is easy for a good lawyer to become overloaded, overcommitted to the point at which he does less than his best. Yet as important as it is for the lawyer to become efficient in the utilization of his time, he must never use this as an excuse to dodge other adversities or to avoid making his substantial contribution on the other four "fronts" listed above.[41]

(6) *The Limits of Individual Competence.* Another adversity is the inevitable limitation of professional competence and expertise. The law explosion has already rendered it impossible for a lawyer to maintain competence and currency in all areas of the law. The notion that any good lawyer, given enough time and resources, can handle any case well is fast becoming a myth.[42]

The age of specialization is upon us. In the sense that this requires increasing competence and expertise on the part of lawyers, I applaud it. To the extent that it causes lawyers to become immersed in one narrow area of the law to the point of losing sight of the big picture, I lament it. And to the extent that it results in the lawyer's surrendering his intellectual and moral independence by adapting, consciously or not, his social, political, and economic views to conform to those espoused by this clients,

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[40] I recall here the words of Teddy Roosevelt quoted in *supra* note 13.

[41] *See* MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 2-25 (amended 1983).

[42] *Id.* EC 2-7, -30.

I positively deplore it. There is, and always will be, room for the lawyer who represents both plaintiffs and defendants. There is, and always will be, room for "the country lawyer" who does a little bit of everything, hopefully fairly well, occasionally associating expert counsel when the novel or unique case is presented. Still, in all areas of the law practice, inevitable human limitations upon competence (coupled with limited time within which to become competent) form a major adversity that each lawyer must first confront within himself. When Chief Justice Burger a decade ago declared that fifty percent of the lawyers in this country were incompetent, no doubt ninety-nine percent of all lawyers placed themselves in the competent half.[43] Yet the need for enhanced professional competence confronts every lawyer.[44] The limits of one's knowledge and capacity for creative legal thought indeed do stand as a major adversity faced by the lawyer in the representation of clients.

(7) *The Tensions Inherent in Lawyering.* Yet another adversity faced by the lawyer in the course of representing clients is the tension inherent in the adversary system. This point should not be lightly passed over. Immersion in the tension between the polar demands of the adversary system is one of the major circumstances of adversity faced by the lawyer. The lawyer's role and responsibilities are plagued by ambiguities, some of which are mentioned at different points throughout this manuscript.[45] Foremost among these is the tension of roles: Between the lawyer's role as an officer of the court and as an advocate for his client. Another tension lies between the client's perception of what is in his best interest and his lawyer's hopefully objective and frequently differing view as to what should be done, and the ever-present tension in the person of counsel opposite. The prac-

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[43] Burger, *The Special Skills of Advocacy: Are Specialized Training and Certification of Advocates Essential to Our System of Justice?*, 42 FORDHAM L. REV. 227, 234 (1973).

[44] I would emphasize here that opposition to mandatory continuing legal education is folly. Those who are not in need of substantial participation in such programs are few and far between. My experience on the court, when I have had to confront such a tremendous variety of difficult legal problems, has reinforced my strong support for mandatory continuing legal education.

[45] *Cf. supra* note 16.

tice of law is not for the faint of heart or those of thin skin.

The lawyer regularly faces the tensions created by the trial-versus-settlement choice. I always found it difficult to keep myself psyched up and ready for trial when I knew settlement was a real possibility. There is the constant tension as to how the lawyer will allocate his time between the lucrative, relatively simple case and the difficult but unremunerative case, between the interesting case and the one that seems routine. It is tempting, when you are so pressed for time, to urge that indigent criminal defendant to go ahead and plead guilty, even though you know you haven't fully explored all the possibilities in his case, so that you can get back to more interesting, more desirable, and more remunerative cases. Yet we must not succumb to that temptation.

The lawyer daily is faced with valid and legitimate, yet conflicting demands upon his time, his talents, his energies and emotions. He is challenged to do a not inconsiderable juggling act.

B. The Sacrifice of Self

Lawyers give their advice and counsel, their advocacy and foresight on behalf of others. It is in the nature of the lawyer's calling, the essence of the lawyer-client relationship, that the lawyer sacrifice of himself in the interest of his client. Several specific forms of such self-sacrifice include:

(1) *The Sacrifice of Time.* To the extent of his legitimate needs, the client has first call on the time of his lawyer. A lawyer is expected to give of himself and of his time to the extent necessary to render the maximum feasible quality legal service to the client. However cynical the lawyer may become about such matters over time, the client's needs and interests are important, indeed often precious, and those needs do not always arise at times most convenient for the lawyer or for his or her family. Those not willing to give the client first call on their time should go into another line of work.

(2) *Financial Sacrifice.* It is indeed a happy fact that the practice of law, even by those who strive to do it heroically, often yields not insignificant financial rewards. Yet here, as much as in any other area, the priorities must be set straight.

The lawyer's first obligation is to serve the interests of his client. Obligation No. 1-A, when litigation is involved, is the lawyer's obligation to the court, an obligation of fidelity, candor, and competent advocacy. Only after these obligations have been discharged may the lawyer properly consider his own financial interest. That a client is not in a position to pay a reasonable fee, or any fee at all for that matter, is never an excuse for a lawyer's provision of inadequate representation or second rate advocacy before the court.[46] Beyond this, the lawyer's obligation to be ac-

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[46] The United States Court of Appeals for the Fifth Circuit has recently reminded us of this premise in Branch v. Cole, 686 F.2d 264 (5th Cir. 1982). Judge Keady had declined to invoke his discretionary authority under 28 U.S.C. § 1915(d) to appoint counsel for an indigent plaintiff. He cited the "difficulty of finding lawyers willing to accept uncompensated appointments." 686 F.2d at 266. The Court of Appeals quite properly refused to accept this excuse, stating:

> We hope that the district court's inability to find counsel willing to take appointments in civil rights actions by indigents is an incorrect perception or that it does not represent a common condition in trial courts. Attorneys admitted to practice in the federal courts of this circuit are, or ought to be, bound in the discharge of their duties as court officers by ethical precepts similar to those set out in the American Bar Association's Model Code of Professional Responsibility:
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> > A lawyer should assist the legal profession in fulfilling its duty to make legal counsel available. (Canon 2) . . . The rendition of free legal services to those unable to pay reasonable fees continues to be an obligation of each lawyer (EC 2-25) . . . When a lawyer is appointed by a court . . . to undertake representation of a person unable to obtain counsel whether for financial or other reasons, he should not seek to be excused from undertaking the representation except for compelling reasons. (EC 2-29) . . . Those persons unable to pay for legal services should be provided needed services. (EC 8-3).
>
> If the court continues to have difficulty in obtaining the voluntary service of counsel despite their ethical responsibilities, it may wish to limit the compensated practice by members of its bar to those willing to accept their share of indigent cases. The lot of appointed counsel may not be an altogether unhappy one financially. 42 U.S.C. § 1988 creates a meaningful prospect of realizing fees from meritorious § 1983 cases. 28 U.S.C. § 1915(d) gives the district court broad discretion to weed out and dismiss frivolous claims, thus increasing the likelihood of success. The district court erred in exercising its considerable discretion to appoint counsel under 28 U.S.C. § 1915(d) by denying such appointment because of the unavailability of counsel.

686 F.2d at 266-67. The *Branch* case has given substantial impetus to the Mississippi State Bar's Pro Bono Project. As of May 2, 1983 some 635 of Mississippi's lawyers—16 percent of the bar—had committed themselves to participation in the program. THE MISSISSIPPI LAWYER, May-June 1983, at 11. While this report is encouraging, I cannot help wondering why the other 84 per cent are not participating.

tive on the fronts of improvement of the quality of justice, public service, and education will almost never be directly financially remunerative.

The practice of law is not just another business. Like all of life, the practice of law has its economic side. Yet if nothing else is clear, it is certain that one departs from the nature of his calling and the traditions of his profession if he allows the economics of the practice of law to be dominant. There is no eleventh commandment that says a lawyer must obtain his fee before he will move a muscle in behalf of his client. There is no twelfth commandment that says every hour, every minute spent on a client's case must be billed. There is no escape from the lawyer's obligation, when setting a fee, to ask whether, if he needed that particular legal service, he could afford himself. It is an indisputable fact that practically any competent lawyer can wholly fulfill each of the obligations that would be imposed upon him under the view of lawyering taken here and still make a more than adequate living.

(3) *The Rigors of Intellectual Self-Discipline.* A third form of self-sacrifice is the requirement that the lawyer be a harsh disciplinarian of his own abilities and his own job performance.[47] The practice of law is an intellectually rigorous and demanding job. Care in the evaluation of strategies, the drafting of documents, the phrasing of thoughts is essential. Rigorous intellectual self-discipline is a part of the makeup of every good lawyer in the representation of clients. Because the lawyer knows that his work is going to be tested and critically evaluated by counsel opposite and because quite frequently he knows his work will be a major part of what the court considers in making its decision, each legal service rendered simply must be the best that the lawyer's talents and energies will allow.

(4) *The Necessity for Objectivity.* Another form of self-sacrifice is in the lawyer's duty to excise those emotions and other thoughts that cloud his judgment. I disagree with those who say that a lawyer must never allow himself to become emotionally involved in a client's plight or cause.[48] Experience has taught me

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[47] *See* MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 6-1, -2 (amended 1983).

[48] More than one lawyer, by keeping himself so distanced from his client, has

otherwise. Yet I know that no lawyer can be effective unless he steels himself so that whatever his client's predicament, the lawyer's objectivity and capacity for critical judgment is not dulled.

(5) *The Sin of Pride.* There is another aspect of the self the lawyer is called upon to sacrifice: his seemingly inevitable tendency to allow his life to be dominated by the sins of pride and self-elevation, of bravado and downright braggadocio.[49] It has been said with truth that there are few among our ranks who will inherit the earth.[50] It takes a special kind of person to be a lawyer. He must be tough minded, quick thinking and self-confident. These qualities, however, often lead to others less laudable — arrogance, brashness, and selfishness. Yet here, as elsewhere, the peculiar role the lawyer is called upon to play is the check from which arises the possibility of his own redemption.

The lawyer works for others. He helps other persons, frequently far less fortunate than he, reach for their stars. He protects them against forces that threaten. He knows that in the end it is the client, not himself, who will celebrate or suffer. Out of this experience he has constantly before him that he ought to eschew the sin of pride.

(6) *Class and Dignity in Professional Comportment.* Finally, a lawyer is required to sacrifice and excise from himself many of the human frailties and failings of other mortals. The nature of the adversary system and process, whether it be in preparation for trial, negotiation, or whatever, presents the lawyer a tough arena in which to work. The adversary battleground, which is the lawyer's turf, necessarily gives rise to feelings of anger, resentment, cynicism and mistrust. A lawyer must control those feelings. He must handle himself with class and dignity. "He should be temperate and dignified."[51] He must never become petty. He must always remember that, no matter how out-

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thereby disserved his client's true needs. A client is a human being. Even a corporation, faceless as some may seem, is a conglomerate of human beings. No lawyer should merely think of his client as an inanimate object serving as the locus of certain legal rights and responsibilities. Yet many lawyers do just this.

[49] I refer here to what Tillich has called the sin of hubris. TILLICH, 2 SYSTEMATIC THEOLOGY 49-51 (1963).

[50] *Cf. Matthew* 5:5 ("Blessed are the meek for they shall inherit the earth").

[51] MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 1-5 (amended 1983).

rageous he considers the conduct of his adversary or counsel opposite, there are almost certainly some valid grounds for a similar criticism toward himself. In short, the lawyer must develop a thick skin and he must develop it early in his experience at the Bar. A good sense of humor, coupled with the ability not to take oneself too seriously, would also help.

C. Pursuit of Noble Ends

To be sure, a person who struggles against great adversity and who does so persistently and without yielding is worthy of our admiration. When he sacrifices of himself, he further is a legitimate object of commendation. Still, before the term heroic may fairly be used to characterize his activities, he must do more. He must pursue noble ends, for a person may struggle against adversity and sacrifice of himself toward heinous or obnoxious ends. Did not Hitler do as much?

The lawyer is daily presented with the opportunity to pursue ends fairly regarded as noble. These ends derive from opportunities inherent in the lawyer's role within the structure of the legal system, the system within which the lawyer functions. They arise from the very nature of the attorney-client relationship. Without doubt, these opportunities have frequently been passed up or subverted. Lawyers with a lost sense of priorities regularly subordinate the nobility of their calling to the pursuit of baser ends. But it is not inevitably so.

A few examples of the noble ends the lawyer is called to pursue:

(1) *Securing Enjoyment of Vested Rights.* It is the bread and butter work of lawyers to assure that rights vested by our law in individuals are secure and are made living and accessible realities, not to be hidden away in books as ideals but to be enjoyed. The lawyer assures that the accused's right to a fair trial before an impartial jury becomes a reality. The lawyer assures that he does in fact have a meaningful opportunity to confront and cross-examine his accusers. The lawyer assures that a tortfeasor does not violate his client's rights under the law with impunity. He assures that rights bargained for and agreed upon in a contract are enforced.

Law is the enterprise of subjecting human conduct to the

governance of rules.[52] These rules may be privately made or agreed upon, such as contracts, trusts, wills, and the like. They may derive from the public policy of the state, such as in our tort law. They may exist in the form of statutes enacted by our legislature, such as is the case with our criminal laws. They may exist in the constitutions of our state and our nation, examples of which are our fundamental rights of freedom of speech, of religion, and the like. The law in its ordering and creative capacities needs lawyers if it is to be enjoyed. The law through the work of lawyers indeed may fairly be said to help make life worthwhile. It is the lawyer's job and responsibility to see that this happens.

(2) *Vindicating Individual Worth.* At the core of all of our law and our legal system is that ultimate ideal of the Judeo-Christian tradition: That each human being is unique; that by virtue of his humanity he possesses an unalienable and undeniable dignity and worth; that he is capable of reason and of aspiring to better his life; that he has within him redemptive possibilities at all times. It is the lawyer's job, purely and simply, to help make this ideal a reality.

Experience teaches us that many forces seek to strip man of his individuality and uniqueness. Foremost among these is the tyranny of the majority bent on a utilitarian approach to solving the problems of organized mass society. To appease this tyrant the individual is subject to sacrifice on the altar of expediency and efficiency as defined by the cost-benefit study.[53]

The individual faced with this plight frequently may need a lawyer. It is the job of lawyers to detect each occasion when the law, the state, or one's fellow citizen attempts to violate one's humanity and to secure the protections of the law.[54] In this way the individual's humanity is vindicated. Through this process law is forged.

(3) *Acceptable Dispute Resolution.* Our legal system has been created to serve society and its members, not vice versa. An individual may not need or desire enforcement of every right

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[52] FULLER, THE MORALITY OF LAW 96 (rev. ed. 1969).

[53] Compare the ideas in Section VI(A)(3) above.

[54] *Cf. supra* note 15.

available to him under the law. Not every legal wrong requires or demands that a lawsuit be filed and that a trial be had. Indeed, under the best of circumstances a lawsuit and a trial is time consuming, expensive, and emotionally draining on all participants.[55]

In organized society people collide. Their interests, their needs, their desires may conflict. Disputes arise. When this happens, often the individual's foremost need is for a reasonably prompt final resolution of the dispute on terms he can live with. It may well be that the best interest of the client calls for a minimally acceptable prompt settlement of his dispute.

Trial is by no means the only acceptable method of dispute resolution. Settlement can save time, expense, and emotional wear and tear. Particularly when the parties must continue to deal with each other after the dispute is resolved, conciliation rather than litigation may be the real need of each. The lawyer must stand ready, willing, and able to go to war for his client, if need be. Yet he should always be alert to the very real possibility that his client needs a peacemaker, not a warrior. Settlement and compromise are signs of weaknesses only in the eyes of the immature. In fact it safely may be said that in the overwhelming majority of all controversies between parties that get into the hands of lawyers, a prompt, peaceable conciliation is a nobler end than trial on the merits.

(4) *Giving Sinners a Second Chance.* Giving a vent to the redemptive possibilities within each of us is another noble pursuit of lawyers. This one is least understood by laymen.[56] It is

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[55] In Magee v. Griffin, 345 So. 2d 1027 (Miss. 1977), Justice L.A. Smith said it well:

> It is, and should be, a paramount concern of the judiciary to prevent multiple suits where one suit will suffice. There is a tendency, perhaps, to forget that one who undergoes the rigors of an action, with all of its traumatic impact, loss of time, delay, substantial expense and disruption of his affairs, with consequent appeals and possible retrials and still other appeals, should be spared having to do this more often than is strictly necessary. Even the successful party after bearing the expense of one trial and of one appeal is, in many instances, hardly a winner.

Id. at 1032.

[56] An occasional thoughtful consideration of the scriptures, by saint and sinner alike, could help eliminate some of this lack of understanding. *See, e.g., Micah* 6:8; *Matthew* 18:21-22.

often asked, "How could you defend one you knew was guilty?" How can the lawyer ethically justify invoking a "legal technicality" to thwart justice?[57]

Before you have standing to demand that each guilty person be punished, you must first turn yourself in for your (undetected) transgressions. Before you scorn the release of the guilty, you must deny the life experience that people do grow when given second chances. Let he who is without sin cast the first stone.[58]

What lawyer has not had the experience of defending someone on a criminal charge and obtaining an acquittal or a discharge from custody "on technical grounds" and seen a grateful though chastened client go forth and sin no more? To be sure, the outcome is not always so happy. But there are hundreds of lawyers in this country who have thus thwarted "justice" and seen his or her client mature into a responsible citizen, often far more responsible and productive than are the carping critics constantly complaining about criminal charges being dismissed on technicalities.

The idea of a redemptive potential within each individual is central in our Judeo-Christian heritage. Lawyers daily are faced with the challenge of sparking that potential into actuality and assuring that the spark is not snuffed out by the legal system. However troublesome and turbulent may be its coexistence with the demands of individual accountability, I insist that its pursuit by lawyers is noble.

(5) *Creation of Opportunities for Economic Gain, Social Enhancement, and Aesthetic Enjoyment.* We have to this point concentrated on the lawyer's role within that aspect of the law devoted to securing social order. Equally important are the law's

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[57] The people who ask these questions seldom have standing to do so. Who among us is without sin? Who among us has not at some time in his life done something he knew to be wrong for which he was never "caught?" Suppose a vindictive witness had been there? Or suppose someone had witnessed his actions and merely not understood the context or placed a wrong interpretation upon them? Each of us at some time in his or her life has done something which, had the proper components of bad luck coalesced at the moment, would have had life-wrecking consequences. Having escaped these potential disasters most of us have learned from the experience and become better citizens than before.

[58] *See John* 8:7; *cf. Matthew* 7:1.

creative powers. Law enables us to do things we otherwise would not be able to do. Law enables people to make plans and arrangements through which their highest dreams and aspirations may be realized. It is the almost daily role of the lawyer to turn these creative potentialities into enjoyed realities.

A simple example may be found with the young couple purchasing their first home. Because such people will almost never have sufficient resources to pay cash, without the creative powers of the law they could never buy the home. Our law, fortunately, enables people to enter into a relatively simple (to the lawyer) set of arrangements—a contract of sale, a warranty deed, a promissory note, and a first deed of trust—which allows seller, purchasers, and mortgage lenders each to realize a substantial benefit. The lawyer employs his skill to translate potentiality into reality.

For example, the need for housing is once again challenging the lawyer's creative capacities. Economic conditions in the home-building industry, coupled with the scarcity of first mortgage loans, are having an unsettling effect. Yet people must have housing, and the law must provide structures through which acceptable housing is made available. The lawyer's creation many years ago of the legal structure for the first mortgage residential loan was a heroic achievement, but that structure is no longer adequate. We need new structures. The condominium has been one response,[59] but it is apparent that more is required. The creative work of filling this need must be done by lawyers.

There are, of course, an infinite variety of far more complex business relationships and organizations. These indeed are at the foundation of the economic structure of our society. In both macro- and micro-economic terms, the law does encourage the growth and economic well-being of our society. The lawyer plays a vital role in enabling our citizenry, individually or collectively through giant corporations, to realize both material and aesthetic dreams, to improve the quality of life.

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[59] *See* The Mississippi Condominium Act, MISS. CODE ANN. § 89-9-1 to -37 (1972). *See generally* Comment, *The Mississippi Condominium Act: An Analysis of Potential Problems*, 44 MISS. L.J. 261 (1973).

D. The Means Employed

No matter how noble the ends one may pursue, his means must also be subject to scrutiny. Noble ends emphatically do not justify any means. No thoughtful person would label heroic the pursuit of noble ends by immoral or dishonorable means.

This is particularly true in the case of lawyers, for in the long run, utilization of dubious means will (and has) undercut the credibility and effectiveness of the profession. Indeed, in the long run, our capacity to achieve the noble ends described above will be severely limited.

Several "means" need be mentioned here:

(1) *Fidelity to the Court.* Honesty and candor with the court, with counsel opposite, and with one's client are obviously essential. Here I am not insensitive to the very real tensions that exist between the lawyer's role as an officer of the court and as a representative of his client.[60] I strongly insist on the preservation of the lawyer's obligation to keep confidential communications with his client. The debate engendered over a decade ago by Professor Monroe H. Freedman may be instructively noted here.[61] Professor Freedman posed three questions:

> 1. Is it proper to cross-examine for the purpose of discredit the reliability or credibility of an adverse witness whom you know to be telling the truth?
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> 2. Is it proper to put a witness on the stand when you know he will commit perjury?

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[60] Some hold to the belief that there is no difference between these obligations. For example, it is stated in the MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 7-19 (amended 1983) that "the duty of a lawyer to his client and his duty to the legal system are the same; to represent his client zealously within the bounds of the law." While I wholly subscribe to much of what is said in the Ethical Considerations stated in our Code of Professional Responsibility, the view stated here is naive. Whether one agrees with Monroe Freedman, I do not see how anyone can doubt that he has accurately described the lawyer's dilemma. Freedman, *Professional Responsibility of the Criminal Defense Lawyer: The Three Hardest Questions*, 64 MICH. L. REV. 1469 (1966).

[61] Freedman, *Professional Responsibility of the Criminal Defense Lawyer: The Three Hardest Questions*, 64 MICH. L. REV. 1469 (1966). This article sparked substantial debate. *See, e.g.*, Freedman & Braun, *Ethical Crisis In Criminal Law*, TRIAL Dec.-Jan., 1967-68, at 34-35 (the authors debate). *Compare* Freedman, *The Professional Responsibility of the Prosecuting Attorney*, 55 GA. L.J. 1030, 1030 (1966-67) *with* Braun, *Ethics In Criminal Cases: A Response*, 55 GA. L.J. 1048, 1048 (1966-67).

> 3. Is it proper to give your client legal advice when you have reason to believe that the knowledge you give him will tempt him to commit perjury?

He answers each of these questions in the affirmative and correctly so. I suggest, with respect, that those who have disagreed with Freedman (a) have never been confronted with these situations in the courtroom, (b) are being less than candid, or (c) fail to give their clients the full allegiance called for by the nature of the attorney-client relationship. My purpose here, however, is not to reargue the Freedman debate. The point is that Freedman's three hardest questions serve to underscore the importance of the *quid pro quo*. If a lawyer is not willing to give the *quid pro quo*, he should hardly be surprised that the public (including some within his own profession) does not leap to his defense when he "practices" affirmative answers to the three hardest questions.

I am loath to speak in absolutes. It seems axiomatic that, so long as client confidences are not compromised, forthrightness and candor with all is a priority—a morally desirable and a practically necessary means—as one pursues noble ends. Still the tensions presented by Freedman's questions are real. The lawyer is tested by how well he functions within these tensions and how well he honors both duty to the client and candor with the court, not by how he rationalizes away one or the other.

(2) *Honesty and Integrity in Handling Others' Property.* The lawyer regularly handles other people's money. Strict ethical standards govern the manner in which he may do so. Those standards demand absolute honesty and integrity. The establishment of a trust account is mandated, assuring that there will be no commingling of the clients' funds with those properly the lawyer's. Here, as in other aspects of his professional conduct, the lawyer must not only avoid any impropriety but also even the appearance of impropriety.[62]

Beyond that, the lawyer is an insider who sees many opportunities not properly his. Business opportunities, the chance to

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[62] *See* MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 9-1 to -6 (amended 1983).

make a favorable investment, the opportunity to purchase property at a favorable price—these present themselves to the lawyer almost daily. As an insider he has access to information not available to others. The lawyer must not yield to temptation. Again, he must avoid even the appearance of impropriety.

(3) *Conflicts of Interest.* Avoidance of conflicts of interest is equally important as the lawyer's means and seems to follow honesty in dealing with the client's money and property. Where the lawyer's loyalties lie and that those loyalties are without conflict with other established professional loyalties, must be known and known unequivocaly. Yet one should not make this statement oblivious to the practical reality of just what strict adherence to our familiar strictures against conflicts of interest means.

In the small town law practice it frequently occurs that a lawyer's "regular" clients have business dealings with each other. To send each to another lawyer whenever this occurs would be time consuming, expensive, and generally undesired by either client. Yet the lawyer must not use this need to be practical to compromise the integrity of his relationship with his clients. Simply put, in such situations the lawyer absolutely may not "take sides." In addition, he must in advance make full disclosure to the clients of the potential conflict of interest and let them, not the lawyer, judge whether independent counsel is needed.

Make no mistake about the fact that a strict adherence to conflict of interest restrictions will at times require a lawyer to pass up desirable opportunities for representation. A lawyer may be representing a client on a relatively small matter at a time when he is tendered the opportunity to sue that client on a substantial, unrelated matter. The tension may become acute with the corporate or institutional client whose business is occasional and not regular. The lawyer must not succumb to this temptation, and it is no justification to say that one is really representing the client's insurer. One should not need to resort to any formal canons of ethics to understand the substantial impropriety of simultaneously proceeding on behalf of, and against, the same nominal party, even though in each instance an insurer or

an underwriter is the real party in interest.[63]

(4) *Diligence and Competence.* Diligence and competence are likewise requisite means for the lawyer.[64] Though mentioned above under the area of sacrifice of self, I emphasize again the lawyer's absolute obligation to bring the highest possible quality of competence to each occasion when he represents the interest of a client. Not everyone ought to be a lawyer. Not everyone who is a lawyer ought to be one. Presumably a combination of a rigid academic curriculum, a bar examination, and the tests of battle under fire will assure that all who hold a license to practice law are minimally competent, at least in the area in which he purports to render service. Sad experience teaches us that this is not true. The pursuit of noble ends by otherwise honorable means is a meaningless gesture when done by one not competent.

Closely related is the requirement of diligence. On the fields of athletic competition, in academia, in the business world, and in every other aspect of life, diligence and hard work can and do compensate for some deficiencies in intellect, aptitude, and ability. Without belaboring the obvious or repeating the point mentioned above, that combination of competence and diligence necessarily are among heroic means.

(5) *Making Sound Reasoned Judgments Quickly.* Without doubt the single most important skill a lawyer must possess is the capacity to make sound, reasoned judgments quickly. The lawyer's judgments and his capacity to make them must be equally informed by common sense and juridical logic.

An important facet of this "means" is the lawyer's duty to bring to bear his independent judgment.[65] To be sure, the lawyer represents a client. The client is the employer—the boss, so to

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[63] From the client's perspective, the lawyer, while representing that client, will almost always have access to inside information which, as zealous counsel opposite, he is obliged to make use of.

[64] MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 6-1 (amended 1983) provides in full: "Because of his vital role in the legal process, a lawyer should act with competence and proper care in representing clients. He should strive to become and remain proficient in his practice and should accept employment only in matters which he is or intends to become competent to handle."

[65] *See id.* EC 5-1 to -24.

speak. The lawyer serves the client and not vice versa, yet the nature of the lawyer's employment is such that he is expected to exercise sound independent judgment. He violates his trust when he simply tells the client what he knows the client wants to hear. Even at the risk of losing financially remunerative representation, the lawyer must not compromise his responsibility to exercise independent judgment and, when the occasion demands, to say "no." That the client may be overbearing or persistent may present practical difficulties but may never justify the lawyer's sacrificing or compromising his independence.

By the same token, there are many persons in need of representation who do not or cannot appreciate or understand their needs and their best interests.[66] The lawyer on occasion is called upon to save the client from his own folly. While the client always has a veto on what the lawyer does, it is the lawyer's duty on occasion to all but insist on a particular course of action. Once the lawyer is satisfied that his critical judgment is sound, he is not free to let a bullheaded client literally put his neck in the noose.

(6) *The Uniqueness and Humanity of the Client.* Another means the heroic lawyer must employ is the recognition that his client is a human being. This is so even though the client is a corporation, for even then the corporate president or chief executive officer is a flesh and blood human being. The particular representation tendered by the client may be a matter wholly routine and unexciting to the lawyer. Yet he must never forget that in all likelihood it is the most important thing in the client's life at that moment. Most people need the services of a lawyer only two or three times during their lifetimes. On these occasions frequently life-shaping events are taking place in the client's life. The lawyer does not have the right or prerogative of limiting his aid to the client to that of a technical, legal nature. However inconvenient or unpleasant, the lawyer by virtue of the relationship of trust and dependence he has with the client, must be psychologist, counselor, and pastor. At the very least

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[66] MISSISSIPPI CODE OF PROFESSIONAL RESPONSIBILITY EC 7-11 (amended 1983) recognizes that "[t]he responsibilities of a lawyer may vary according to the intelligence, experience, mental condition or age of a client, . . . or the nature of a particular proceeding."

this includes having a caring attitude toward each of one's clients, no matter how despicable the behavior that got him into the predicament that required him to seek legal counsel in the first place, and no matter how much otherwise he may "drive you up the wall."

(7) *Ethical Considerations En Route.* It is widely accepted within the profession that the lawyer is personally indifferent to the moral propriety of his client's actions or goals. Without doubt, any lawyer limiting his practice to the representation of those whose actions are wholly acceptable or whose ends are wholly laudable will soon go broke. Rejection of clients on this basis would seriously compromise a fundamental premise of our system: that sinners and saints and all in between stand equal in the eyes of the law in their entitlement to ready access to competent legal service.[67]

I insist, however, that the lawyer has a serious though delicate responsibility regarding the moral and ethical propriety of his client's actions and ends. The Mississippi Code of Professional Responsibility states the point too meekly when it says: "In assisting his client to reach a proper decision, it is often desirable for a lawyer to point out those factors which may lead to a decision that is morally just as well as legally permissible."[68]

As in so many other aspects of his professional life, the lawyer lives within the tensions created by the ambiguities of lawyering. At one polar extreme we insist that the client's individuality and integrity be preserved inviolate. At the other, I believe it not only desirable but positively obligatory that the lawyer present to his client appropriate moral and ethical considerations. As elsewhere, I find little use in an either/or debate. The lawyer must respect both of these considerations — and function within the tensions they create.

VII. Are There Lawyer Heroes Among Us Today?

Are there then heroes within our ranks? Many would answer no, with a hearty laugh at the very idea. "When I know a

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[67] The problem here, of course, is that we live in a pluralistic society. My sinner may be your saint, and vice versa.

[68] Mississippi Code of Professional Responsibility EC 7-8 (amended 1983).

lawyer is in the room, I hold on to my pocketbook," others cynically reply. "The security of a community is inversely related to the number of lawyers who live there," still others scoff. "Lawyers have turned us into an overly litigious society and have thus destroyed the basic humanistic values of our Western liberal, Judeo-Christian tradition," others more thoughtful may say.

There is more than a kernel of truth in what these critics say. We are our own worst enemies. We have not behaved very much like heroes. Yet none of that changes our possibilities for the future.

The lawyer's circumstances, today as ever, place him inevitably in the midst of those polar alternatives: hero or villain. Today, as ever, he must play his special role on behalf of others. He must insist on exemption from societal norms governing all others. He must understand that there is the *quid pro quo* and he must accept it cheerfully. As he demands these exemptions in order to serve others, he must do nothing that would cause others to suspect that he is serving himself.

To be sure, lawyers are drawn from the ranks of ordinary mortals. There will always be within the Bar rascals, scoundrels, and those whose being is dominated, at least for a time, by baser instincts. Among our ranks are the cunning, the cold and the unfeeling. There will always be the brilliant tactician who will do anything for a fee.

The circumstances of our calling offer great opportunities for villainy.

Those same circumstances, as sure as it is that the sun will rise tomorrow, will yield heroes. For it is an observable phenomenon that the same lawyer who one day is a cynical ambulance chaser is capable of more. When confronted with another in need, one whose liberty is threatened, whose dreams are in jeopardy, this lawyer, because he too is endowed with an indomitable will and a charitable spirit, responds. I have seen it happen time and time again. So often when they would have been embarrassed at the thought—or, because selfless were simply unaware— I have seen lawyers behave as heroes. Justice Holmes said it simply: "the practice of . . . [law] in spite of popular

jests, tends to make good citizens and good men."[69] Yet his thought was profound and has been verified by experience. I suspect that most of us are better men and women and better citizens than we would have been had we not become lawyers.

There are more challenges today for the lawyer to serve heroically than ever before, more opportunities to be good citizens. As never before the lawyer is called upon to say "no" to the state and its computer which would sacrifice all at the altar of "1984." The lawyer in the name of the individual must say "no" to big business and its technology, which would sacrifice all on the altar of the profit and loss statement—and we must not forget that the individual in top management is just as individual as the consumer, just as susceptible of being stripped of his humanity for the sake of the organization, efficiency and profit. The lawyer is called upon to say "no" to unions and other employee associations if they would sacifice merit and achievement in favor of security.

The lawyer in the name of the individual must say "no" to mass society and its media, which would sacrifice us all on the altar of mediocrity and banality—and to that same media when it refuses to give its own *quid pro quo* and flouts the public interest, in furtherance of some arrogantly arrogated status as trustee of the public's right to know.

And the lawyer must say "no" to the hangman whose approach looms more ominous than ever in our history.[70]

These things, and so much more, the lawyer must do in the face of great adversity. He will be called upon to make great sacrifices of self, to steel himself to the task of the protection and nourishment of the being and spirit of the individual client as never before. If he understands and is prepared to give the *quid pro quo*, his ends will by definition be noble, his means beyond reproach.

We all have our heroes. Among my non-lawyer heroes is Walt Whitman, our greatest democrat. Like other heroes, Whitman was far from perfect. He was so in the last section of "Song

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[69] Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 459 (1897).

[70] According to the New York-based Legal Defense Fund, as of June 20, 1983 there were 1202 prisoners on Death Row in the United States.

of the Open Road,"[71] when he called to his companion: "Allons! the road is before us! It is safe—I have tried it—my own feet have tried it well—be not detain'd!

. . . .

Let the preacher preach in his pulpit! let the lawyer plead in the court and the judge expound the law."[72]

So much of "Song of the Open Road" is brilliant, moving, human, inspiring. But Whitman did not see that the lawyer pleading in the court is indeed in the mainstream of the Open Road of Western liberal democracy.

Or did he? Is not Whitman's Open Road the path of our law, the road all lawyers are called upon to tread? Did not Whitman recognize, at the outset of his poem, that which is basic to our law and to lawyering when he wrote:

> Here the profound lesson of reception, nor preference nor denial,
> The black with his wooly head, the felon, the diseas'd, the illiterate person, are not denied;
> The birth, the hasting after the physician, the beggar's tramp, the drunkard's stagger, the laughing party of mechanics,
> The escaped youth, the rich person's carriage, the fop, the eloping couple,
> The early market-man, the hearse, the moving of furniture into the town, the return back from the town,
> They pass, I also pass, any thing passes, none can be interdicted,
> None but are accepted, none but shall be dear to me.[73]

These and all others our law respects. These and all others are among those whose dignity and worth are sacred. These and all others lawyers are called upon to accept and to serve. And when they do so, against all adversity, without regard to self,

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[71] Whitman, *Song of the Open Road*, in LEAVES OF GRASS (1859).

[72] *Id.* at stanza 15.

[73] *Id.* at stanza 2.

employing all honorable means, lawyers are indeed among society's heroes.

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COMMENTS

AN ANALYSIS OF THE APPLICATION OF THE CLEARLY ERRONEOUS STANDARD OF RULE 52(a) TO FINDINGS OF FACT IN FEDERAL NONJURY CASES

Introduction

The scope of appellate review of findings of fact in non-jury cases in federal courts is governed by rule 52(a) of the Federal Rules of Civil Procedure, which states in pertinent part that "[f]indings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."[1] The dispute regarding appellate review predates the Constitution and, despite the adoption of rule 52 in 1936 and its subsequent amendment, continues today.

The ancient friction between advocates of the common law and those who favored equity, and between the Federalists, who favored a strong central government, and the Anti-Federalists, who did not, had a great effect on the procedures used in the federal court system. Each time one faction gained sway over its opposition, judicial practice was amended. Although law and equity have been merged in the federal court system, some vestiges of the smoldering strife remain. One of these battlefields is the scope of appellate review in cases tried by a judge without a jury.

Although the language of the rule itself is plain enough, as is the intent of the members of the committee which drafted it, because of some ambiguous language in the notes to the rule,[2] and the uncertain nature of the history to which it refers, the decisions applying rule 52(a) are inconsistent and confusing. Some circuit courts of appeal apply the rule selectively, confusing the distinction between law and fact and/or drawing a distinction between types of evidence for purposes of

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[1] Fed. R. Civ. P. 52(a).

[2] The rule is said to be in accordance with "modern federal equity practice." Fed. R. Civ. P. 52(a) advisory committee note. *See infra* notes 115-17 and accompanying text.

appellate review.[3] The circuits differ even within themselves on application of these doctrines.[4] Some of the decisions blur the distinctions between the doctrines to the extent that it is difficult to determine which is being applied.

This comment will set forth a history of the provision and analyze those decisions which construe it. It will be shown that while there is some support for applying the rule selectively, the better view is that the clearly erroneous standard of rule 52(a) should be applied to findings of fact in all cases.

I. HISTORY

The authority of the federal judiciary was one of the crucial issues in the debate of the structure of the new government as set forth in the Constitution.[5] The Constitution, as proposed, provided that "the supreme court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make."[6] Immediately following the War of Independence, many observers feared that allowing a judge the final word in a legal proceeding would negate the citizen's right to trial by jury of his peers, which was thought to be a cornerstone of freedom from autocratic power.[7]

The constitutional provisions establishing the judicial branch engendered an acrimonious controversy that threatened the acceptance of the entire constitution, and indeed the fledgling government itself.[8] The Federalists and Anti-Federalists compromised by adopting the Constitution with the addition of the seventh amendment.[9] This amendment, in addition to reiterating the right to trial by jury, stated that "no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law."[10] Thus, while jury verdicts were constitutionally protected from

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[3] *See* Note, *Federal Rule of Civil Procedure 52(a) and the Scope of Appellate Fact Review: Has Application of the Clearly Erroneous Rule Been Clearly Erroneous?*, 52 ST. JOHN'S L. REV. 68, 68-69 (1977).

[4] *See infra* notes 55, 105, 118, 121 and accompanying text.

[5] Warren, *New Light on the History of the Federal Judiciary Act of 1789*, 37 HARV. L. REV. 49, 54 (1923).

[6] U.S. CONST. art. 3, § 2, cl. 2.

[7] *See* Clark & Stone, *Review of Findings of Fact*, 4 U. CHI. L. REV. 190, 192 (1936).

[8] Warren, *supra* note 5, at 54.

[9] *Id.* at 53-56. Many still opposed the Constitution but were willing to accept it as it was with the hope that it could be amended later. *Id.* at 55.

[10] U.S. CONST. amend. VII.

review in the presence of sufficient supporting evidence,[11] findings of law made by a judge were not governed by any similar rule.[12]

The dispute between Federalists and Anti-Federalists, equity partisans and common law advocates, was renewed by the introduction of the Judiciary Act of 1789.[13] Prior to this time, American and English equity practice provided for de novo review on appeal of findings of fact as well as findings of law.[14] After a bitter dispute concerning whether the methods for review and for taking evidence in federal courts would be those of law or equity,[15] Congress enacted the Judiciary Act of 1789.[16] This statute provided for review of decisions at equity by the common law procedure of writ of error,[17] and substituted

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[11] 5A J. MOORE, J.D. LUCAS, MOORE'S FEDERAL PRACTICE ¶ 52.02 (2d ed. 1982) [hereinafter cited as MOORE].

[12] *Id.* ¶ 52.03[2]. Appellate review of findings of fact in equity and admiralty cases was left to the discretion of Congress. Warren, *supra* note 5, at 75, 103.

[13] *See* Warren, *supra* note 5, at 67-68.

[14] Warren, *supra* note 5, at 102-03. Several of the American colonies diverged from the English practice. Although de novo review was allowed at this time, there is considerable dispute concerning the scope of review actually applied. *See infra* notes 115-19 and accompanying text (restrictions on scope of equity review). Also, some states had no chancery courts at all, while others allowed for review of equity cases by means of a writ of error, rather than by appeal. POUND, APPELLATE PROCEDURE IN CIVIL CASES 101-02 (1941). *See also infra* note 17 (distinction between appeal and writ of error).

[15] Warren, *supra* note 5, at 96. There was an attempt to abolish equity jurisdiction altogether. *Id.* This attempt failed; the Act as proposed and adopted allowed equity courts jurisdiction when there was no "plain, adequate and complete remedy . . . at law." *Id.* at 97; *see* First Judiciary Act of 1789, ch. 20, § 16, 1 Stat. 73, 82. Opponents of the chancery system then attempted to stamp out equity by amending the Act. One amendment would have required that trial of facts in equity cases be by jury; this proposal failed. Warren, *supra* note 5, at 99. Another, which was adopted, required that equity and admiralty courts hear evidence by oral testimony and examination of witnesses in open court, the same as common law courts. *Id.* at 100. This was a great victory for the anti-chancery party, but it became such a burden upon courts of equity that it was later repealed by the Act of April 29, 1802, which provided that "it shall be in the discretion of the Court upon the request of either party to order the testimony of the witnesses therein to be taken by depositions." Act of April 29, 1802, ch. 31, § 25, 2 Stat. 156, 166. *See* Warren, *supra* note 5, at 100. The anti-chancery party then turned its attention toward the scope of review. Because of the rancorous argument during and after debate of the Constitution, the drafters of the Judiciary Act decided that there should no longer be any appeal of determinations of fact in *any* class of cases, and so allowed for review only of questions of law and then only by writ of error. Warren, *supra* note 5, at 102-03.

[16] First Judiciary Act of 1789, ch. 20, 1 Stat. 73.

[17] Warren, *supra* note 5, at 102. The Supreme Court has defined the distinction between appeal and writ of error as follows: "An appeal is a process of civil law origin, and removes a cause entirely; subjecting the fact as well as the law, to a review and retrial: but a writ of error is a process of common law origin, and it removes nothing for re-examination but the law." Wiscart v. Dauchy, 3 U.S. (3 Dall.) 321, 327 (1796).

the common law methods of taking evidence by oral testimony and examination of witnesses for the equity practice of taking evidence by deposition.[18] These two provisions greatly lessened the distinction between law and equity and increased the importance of the trial court's role in determining the credibility of witnesses.[19]

Rather than eradicating equity practice, the onerous provisions of the Act of 1789 were merely a nuisance, and after the defeat of the Federalist party in 1800, the Act was repealed.[20] In 1802, Congress provided that upon request of either party to an equity action the court might order the testimony of a witness to be taken by deposition.[21] In 1803, appeals were substituted for writs of error in equity and admiralty cases.[22] Following the re-establishment of the law-equity dichotomy by the Acts of 1802 and 1803, the two systems evolved separately, developing distinct rules of procedure, including separate rules for review.[23]

The review issue again arose as a result of the enactment of the Act of 1865, which provided for waiver of the right to trial by jury in civil actions and for trial of questions of both law and fact by the trial judge sitting without a jury.[24] In a victory for the advocates of the common law, the method of review chosen for these cases was the common law method of writ of error. Thus the distinction between law and equity review was made even more plain, based not on convenience or on the right to jury trial but on the difference between actions at law and at equity.[25]

Subsequently, because of outside pressures upon the judiciary[26] and the traditional practices of appellate courts, the distinctions again

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[18] Warren, *supra* note 5, at 100. *See* First Judiciary Act of 1789, ch. 20, § 30, 1 Stat. 73, 88-90 (1789).

[19] Note, *supra* note 3, at 70 n.10.

[20] Clark & Stone, *supra* note 7, at 196.

[21] Act of April 29, 1802, ch. 31, § 25, 2 Stat. 156, 166.

[22] Act of March 3, 1803, ch. 40, § 2, 2 Stat. 244, 244. This statute provided for appeals in equity cases and was later construed as eliminating the writ of error. *See* The San Pedro, 15 U.S. (2 Wheat.) 132, 137-42 (1817).

[23] Clark & Stone, *supra* note 7, at 197.

[24] Act of March 3, 1865, ch. 86, § 4, 13 Stat. 500, 501.

[25] Clark & Stone, *supra* note 7, at 198-99.

[26] Clark and Stone postulate that because of pressure from the emergence of code pleading, which placed an emphasis upon the convergence of law and equity, and because of pressure brought to bear upon the courts by the growth and complexity of the nation's commerce, there was pressure to restrict the scope of review at equity. Clark & Stone, *supra* note 7, at 199-203. This strain was eased by creation of the circuit courts of appeals in 1891, *id.* at 203, but the impetus toward union of law and equity remained.

became blurred. Although appellate courts ostensibly had the power of de novo review of findings of fact in equity cases,[27] there is some evidence that the equity courts observed certain limitations upon their authority.[28] Equity courts probably restricted the scope of their review power to something less than de novo review,[29] thus lessening the distinctions between law and equity review.

In 1912 the federal courts moved closer to the union of law and equity with the promulgation of Equity Rule 46.[30] The rule allowed equity claims to be transferred to law courts, and restored the provisions of the Judiciary Act of 1789 that testimony in suits in equity be taken in open court and that the court rule upon the admissibility of all evidence offered, just as in proceedings at law.[31]

After an abortive attempt at reform by legislative action,[32] the Supreme Court adopted Equity Rule 70 ½.[33] The rule required that the trial court in equity cases "find the facts specially and state separately its conclusions of law thereon . . . ."[34] Further, such findings were required to be entered of record and submitted to the reviewing court on appeal.[35] Rule 70 ½ became the basis for a substantial portion of Rule 52(a).[36]

Meanwhile Congress authorized the Supreme Court to finally

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[27] C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE, 9 Civil § 2571 (1971) [hereinafter cited as WRIGHT & MILLER].

[28] *See infra* notes 115-19 and accompanying text.

[29] *Id.*

[30] *See* 226 U.S. 661 (1912).

[31] *Id.*

[32] In 1928, a statute was enacted that substituted the appeal for the writ of error in all cases, civil and criminal. *See* 28 U.S.C. § 861a (1936). Because of heated opposition by some lawyers and judges who feared that it substituted equity review for common law review, the statute was emasculated by another statute passed later that year. Clark & Stone, *supra* note 7, at 204. The second enactment provided that statutes that applied to the writ of error would henceforth apply to the appeal, thus making the writ of error an appeal in name only. *Id.* at 204-05 (citing Weinstein v. Black Diamond S.S. Corp., 31 F.2d 519 (2d Cir. 1929)).

[33] 281 U.S. 773 (1930). It should be noted that this rule was amended twice, but neither amendment is relevant to this discussion. *See* 281 U.S. 773 (1930), *as amended*, 296 U.S. 671 (1935).

[34] Equity Rule 70 ½, 281 U.S. 773 (1930).

[35] *Id.*

[36] *See* FED. R. CIV. P. 52(a) advisory committee note (rule 52(a) "substantially continue[s]" Equity Rule 70 ½, as amended). Rule 52(a) requires that in all non-jury cases the court shall find the facts specially and state separately the conclusions of law drawn from them. *See* FED. R. CIV. P. 52(a). Equity Rule 70 ½ is almost identical. *See* EQUITY R. 70 ½, 281 U.S. 773 (1930), *as amended*, 296 U.S. 671 (1935).

unify law and equity in the federal court system.[37] The Advisory Committee appointed by the Court[38] to assist in effectuating this change recommended that the rule read as follows: "The findings of the court in [all non-jury cases] shall have the same effect as that heretofore given to findings in suits in equity."[39] The Committee recommended that review in non-jury cases be de novo, stating that this was the equity system.[40]

Following heated debate,[41] the rule was changed to read as it does

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[37] *See* Act of June 19, 1934, 48 Stat. 1064 (current codification at 28 U.S.C. § 2072 (1966)).

[38] *See* 295 U.S. 774 (1934) (members of Advisory Committee).

[39] Note to the Supreme Court, Preliminary Draft, Federal Rules of Civil Procedure 118 (1936).

[40] It was the opinion of the Advisory Committee that in order to unify law and equity, the systems of review would somehow have to be merged. WRIGHT & MILLER, *supra* note 27, at § 2571. For a discussion of the scope of review in equity, see *infra* notes 115-19 and accompanying text.

[41] The Committee adopted a system for review in federal non-jury cases that provided "the review in jury-waived cases is made that of the equity practice, thus leaving all cases tried without a jury to be fully reviewed upon appeal." Note to the Supreme Court, Preliminary Draft, Federal Rules of Civil Procedure 120-21 (1936).

Dean Charles Clark, reporter for the Committee, would have extended the review used in actions at law to all cases tried without a jury. *See* Clark, *Letter to the Editor*, 20 J. AM. JUD. SOC'Y 129, 130 (1936); Clark & Stone, *supra* note 7, at 217. Clark summarized his reasons as follows:

> On the whole, therefore having in mind the advantages of simplicity and uniformity, of compatibility with other federal jurisdictions, of reducing appeals and complex records, of giving due weight to the findings of the judge who actually hears the witnesses, and of limiting reversals except on substantial grounds while nevertheless affording ample power to correct where necessary, there would seem a substantial basis for argument of extending the law review . . . to all cases alike.

Clarke & Stone, *supra* note 7, at 217. In another article, Dean Clark reiterated his opposition, on grounds that "law review . . . gives dignity and responsibility to the trial court, it affords all the opportunity needed for the appellate court to reverse for substantial error or failure of justice, it does not keep alive a divided system, and it does not hold out so extensive an invitation for appeals." Clark, *Letter to the Editor*, 20 J. AM. JUD. SOC'Y 129, 130 (1936).

Dean Clark's contemporaries were divided on the issue. District Judge W. Calvin Chesnut agreed with Dean Clark for primarily the same reasons, *see* Chesnut, *Analysis of Proposed New Federal Rules of Civil Procedure*, 22 A.B.A. J. 533, 540-41 (1936), although he conceded that "[p]erhaps my point of view may be thought to be somewhat colored because it is advanced by a district judge." *Id.* at 540.

Professor William Blume countered Judge Chesnut's argument that the trial judge's position would be derogated, *see* Chesnut, *supra*, at 540, by arguing that the proposed rule would "tend to strengthen and exalt the position of the district judge" because the findings of a judge are not given less weight than those of a jury, but rather, by the Act

today.[42] Additionally, two explanatory notes were added.[43] The rule has since undergone two more relatively minor amendments, neither of which is relevant here.[44]

II. Judicial Interpretation of Rule 52(a)

The clearly erroneous standard for review of findings of fact, now embodied in rule 52(a), had its origin in the ancient traditions of equity courts.[45] More recently, the clearly erroneous standard was interpreted by the Supreme Court as follows: "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed."[46] The deference actually accorded to the trial court's findings varies from jurisdiction to jurisdiction. One court has gone so far as to say that the findings "will be given the force and effect of a jury verdict."[47] This clearly contravenes the intent of the drafters of rule 52.[48] "Blind deference" to the findings of the trial

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of 1865 the judge's findings were given more weight than those of the jury, which "legislative error" the rule would correct. Blume, *Review of Facts in NonJury Cases,* 20 J. Am. Jud. Soc'y 68, 71 (1936); see *supra* note 24. Professor Blume noted that the trial court's authority has always been subject to judicial review, and to accord it greater finality would "arouse distrust and suspicion in the public mind" and the power of district judges "would soon become odious and the object of attack." Professor Blume also asserted that even when there is demeanor evidence an appellate court is in a better position to make a factual determination because more time is available for study of the record. Finally, Professor Blume argued that "[t]he court should be able to look at the result in the light of the evidence to see if justice has been done. To do this the reviewing court must have power to review the facts as well as the law." Blume, *Review of Facts in Jury Cases—The Seventh Amendment,* 20 J. Am. Jud. Soc'y 130, 132 (1936).

[42] *See* Fed. R. Civ. P. 52(a).

[43] Note of Advisory Committee, 28 U.S.C. app. 5170-71 (1958). *See infra* note 108 and accompanying text.

[44] The rule was amended in 1948 to clarify its effect on cases tried with an advisory jury, to permit the opinion or memorandum of the lower court to constitute the findings of fact and conclusions of law, and to make clear that findings and conclusions are unnecessary on most motions. Wright & Miller, *supra* note 27, at § 2571. Rule 52 was amended in 1963 so that it would comport with rule 58, which concerns entry of judgments. *Id.*

[45] *See infra* notes 115-19 and accompanying text.

[46] United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948). Although Judge Learned Hand stated in United States v. Aluminum Co. of America, 148 F.2d 416, 433 (2d Cir. 1945), that it is "idle" to attempt to define the standard, the definition given by the Supreme Court has been used universally. Wright & Miller, *supra* note 27, at § 2585.

[47] Stoody Co. v. Royer, 374 F.2d 672, 681 (10th Cir. 1967).

[48] *See infra* note 107 and accompanying text.

court is not required; "substantial deference" is the standard.[49] It has been stated that the trial court's findings "come [to the appellate court] well armed with the buckler and shield" of the clearly erroneous rule,[50] but, as shown below, the degree of protection afforded by the clearly erroneous standard may be of little importance when the appellate court merely circumvents it by one method or another.

Application of the clearly erroneous standard is not so simple as its definition. Because of the discretion inherent in the standard, an appellate court can always find some method of justifying a reversal, even in the face of the plain language of rule 52(a).[51] An analysis of the methods used follows.

A. The Law/Fact Distinction

Rule 52(a) requires that the trial court separately state its findings of fact and conclusions of law.[52] Because rule 52(a) applies only to questions of fact,[53] a determination whether an issue is one of law or fact is crucial; but in many situations such a distinction is nearly impossible to make. Although it is fairly obvious that a question that involves only the reconstruction of acts or events that actually have occurred is a question of fact,[54] and a question that entails the identification of broad principles for application to the parties' conduct is a question of law,[55] the point at which a question ceases to be one and becomes the other is much less obvious.

Rule 52(a) provides no particular guidance at all on this question.[56] Furthermore, the cases offer very little concrete help — the cir-

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[49] Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 123 (1969). *See also* United States v. National Ass'n. of Real Estate Bds., 339 U.S. 485, 495-96 (1950) (that appellate court might have found facts differently is not sufficient to merit overturning findings of trier of fact).

[50] Horton v. United States Steel Corp., 286 F.2d 710, 713 (5th Cir. 1961).

[51] *See* Wright, *The Doubtful Omniscience of Appellate Courts,* 41 MINN. L. REV. 751, 751 (1957).

[52] FED. R. CIV. P. 52(a).

[53] *See* Pullman-Standard v. Swint, 456 U.S. 273, 287 (1982) (rule 52(a) does not apply to conclusions of law); United States v. Mississippi Valley Generating Co., 364 U.S. 520, 526 (1961) (same); United States v. United States Gypsum Co., 333 U.S. 364, 394 (1947) (appellate court may freely correct errors of law); Shultz v. Wheaton Glass Co., 421 F.2d 259, 267 (3d Cir. 1970) (appellate court not required to apply 52(a) to legal inferences).

[54] *See* Weiner, *The Civil Jury Trial and the Law-Fact Distinction,* 54 CALIF. L. REV. 1867, 1869-70 (1966).

[55] *Id.* at 1869.

[56] *See* FED. R. CIV. P. 52(a).

cuits are in conflict between and within themselves.[57] There is also some uncertainty concerning the weight to be given to the trial court's determination whether a question is one of law or fact, but generally, the circuits ignore the lower court's classification of its findings.[58] Finally, because it is the appellate court that determines whether a finding is one of fact or law[59] and thereby establishes the scope of review for itself, the possibility exists that the appellate court will allow its opinion of the justness of the lower court's ruling to shade its decision.[60]

Some guidance was provided by the Ninth Circuit in *Lundgren v. Freeman*,[61] in which the court stated that findings of fact are those whose resolution is "based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct."[62] Legal conclusions are those which are "based on application of a legal standard."[63] Obviously, this is not of much practical value, so it

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[57] *Compare* Martin v. United States, 586 F.2d 1206, 1211 (8th Cir. 1978) (clearly erroneous standard applies to inferences drawn by trial court from stipulated or undisputed facts) *with* Reserve Ins. Co. v. Brokerage Surplus Corp., 570 F.2d 487, 491 (3d Cir. 1978) (clearly erroneous rule does not apply to inferences drawn by trial judge from stipulated facts); *compare* Goldberg v. P&L Equip. Co., 311 F.2d 88, 89 (5th Cir. 1962) (trial judge's findings of fact entitled to no particular weight because drawn from undisputed facts) *with* National Sur. Corp. v. Wells, 287 F.2d 102, 107 (5th Cir. 1961) (it is business of trial judge to draw inferences from undisputed facts). *See also* Weiner, *The Civil Nonjury Trial and the Law-Fact Distinction*, 55 CALIF. L. REV. 1020, 1023, 1023 nn.25-26 (1967).

[58] *See, e.g.*, East v. Romine, 518 F.2d 332, 338-39 (5th Cir. 1975) (although trial court classified finding as "finding of fact", appeals court re-classified as "ultimate fact"); *cf.* Lewis v. Baune, 534 F.2d 1115, 1119 (5th Cir. 1976) (a trial court's characterization of its proceedings is a factor to be considered, but not determinative). *See also* WRIGHT & MILLER, *supra* note 27, at § 2588.

[59] If the trial court's labeling of the issues is not determinative, then the appellate court, obviously, makes that determination. *See, e.g.*, Baumgartner v. United States, 322 U.S. 665, 671 (1944); Cordovan Associates, Inc. v. Dayton Rubber Co., 290 F.2d 858, 860 (6th Cir. 1961); Houck v. Hinds, 215 F.2d 673, 676 (10th Cir. 1954); Benrose Fabrics Corp. v. Rosenstein, 183 F.2d 355, 357 (7th Cir. 1950).

[60] *See* Note, *supra* note 3, at 90. Conceivably an appellate court may re-classify a conclusion as one of law, thereby removing it from the ambit of rule 52. Conversely, if the appellate court were satisfied with the ruling of the lower court, it could rule that a legal conclusion established by the lower court was one of fact. *See* Ruby v. American Airlines, Inc., 329 F.2d 11, 23 (2d Cir. 1964) (Friendly, J., dissenting) (labelling the trial judge's legal conclusion a finding of fact is one way for appellate judges to avoid reversing the lower decision when the result suits them), *vacated as moot sub nom.* O'Connell v. Manning, 381 U.S. 277 (1965).

[61] 307 F.2d 104 (9th Cir. 1962).

[62] *Id.* at 115.

[63] *Id.*

is not surprising that the cases differ.

Courts, for example, have disagreed concerning whether likelihood of confusion in a trademark case is a question of fact or law;[64] whether

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[64] *Compare* Sarah Coventry, Inc. v. T. Sardelli & Sons, Inc., 526 F.2d 20, 22 (1st Cir. 1975), *cert. denied*, 426 U.S. 920 (1976) *with* Fleischmann Distilling Corp. v. Maier Brewing Co., 314 F.2d 149, 152 (9th Cir. 1963), *cert. denied*, 374 U.S. 830 (1963). In *Sarah Coventry*, the First Circuit compared the name "Sarah" with the name "Sarde" and upheld the lower court's finding that there was no infringement. 526 F.2d at 22. Interestingly, the First Circuit stated, probably correctly, that this was a finding of fact; it then went on to say that this determination was "at best, a mixed question of law and fact." *Id.* If this were a mixed question of law and fact, however, the clearly erroneous standard should not have been applied. *See infra* notes 68-70 and accompanying text. In *Fleischmann*, the Ninth Circuit determined that the question of the likelihood of confusion between Black & White beer and Black & White scotch whiskey was one of law. 314 F.2d at 152.

It is not only the courts that are confused on this issue. At least one commentator has confused cases that decided whether a question is one of fact or law with those that involved the use of a different review standard for "ultimate" and "subsidiary" facts. *See* Note, *supra* note 3, at 88-90. The commentator asserts that in another trademark case, J.B. Williams Co. v. Le Conte' Cosmetics, Inc., 523 F.2d 187 (9th Cir. 1975), *cert. denied*, 424 U.S. 913 (1976), the Ninth Circuit decided that the likelihood of confusion is a question of law. Note, *supra* note 3, at 88. In *Williams*, the Ninth Circuit, discussing whether likelihood of confusion is a quesiton of law or fact stated that:

> With the actual appearance on [sic] evidentiary fact, the next step was to decide whether to a reasonable viewer the marks were similar in appearance. That finding, if affirmative, would be aggregated with the other factors and the aggregate assessed as a foundation for the *ultimate* "likelihood of confusion" determination. Individually, each of these findings is *preliminary* to and not *per se* determinative of the *ultimate* issue.

523 F.2d at 192 (emphasis added).

Thus, rather than basing its decision that the question is one of law solely on the law/fact distinction, the court used the ultimate fact doctrine (*see infra* notes 71-95 and accompanying text) as well as the undisputed evidence doctrine. 523 F.2d at 192. For a discussion of the undisputed evidence doctrine, see *infra* notes 102-43 and accompanying text.

The *Fleischmann* case also involved undisputed facts, but it does not appear that the court used that as a factor in establishing the parameters of its authority to review, although it cites other cases that discuss the doctrine. 314 F.2d at 152 (citing Sleeper Lounge Co. v. Bell Manufacturing Co., 253 F.2d 720 (9th Cir. 1958) and Miles Shoes, Inc. v. R.H. Macy & Co., 199 F.2d 602 (2d Cir. 1952)). The *Fleischmann* court adopted language from Lundgren v. Freeman, 307 F.2d 104, 115 (9th Cir. 1962), which rejects the undisputed evidence doctrine. It then quotes an excerpt from Stevenot v. Norberg, 210 F.2d 615, 619 (9th Cir. 1954), which states that "[w]hen a finding is essentially one dealing with the effect of certain transactions or events, rather than a finding which resolves disputed facts, an appellate court is not bound by [rule 52(a)] but is free to draw its own conclusions." While the *Fleischmann* court ruled that the questions facing it were questions of law drawn from undisputed facts, it does not appear that the *Fleischmann* court ruled as it did because the facts were undisputed but rather because it was of the opin-

the interpretation and construction of written contracts are matters of law;[65] and the nature of a finding that a master and servant relationship does or does not exist.[66] It is beyond the scope of this paper to provide an exhaustive discussion of the distinction between questions of fact and questions of law.[67] It is sufficient to say that an appellate court that determines that an issue is one or the other in order to apply a favored standard of review has compromised its integrity.

A generally accepted principle that hinges upon the law/fact distinction states that findings that consist of mixed questions of law and fact are not subject to the clearly erroneous standard.[68] Apparently this is because rule 52(a) expressly applies only to findings of fact.[69] The clearly erroneous standard is not applied because at least some legal reasoning is involved.[70]

From the mixed question principle comes the ultimate fact doctrine. As with anything that has at its heart the distinction between law and fact, the definition of the term "ultimate fact" is somewhat

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ion that the question of likelihood of confusion is a question of law.

[65] *Compare* Saturn Oil & Gas Co. v. Northern Natural Gas Co., 359 F.2d 297, 302-03 (8th Cir. 1966) (interpretation of contract is question of fact) *and* West v. Smith, 101 U.S. 263, 270 (1879) (if effect of written contract depends not merely on construction but upon extrinsic facts, inferences drawn therefrom are factual, not legal) *with* Gulf, C. & S.F. Ry. v. Coca-Cola Bottling Co., 363 F.2d 465, 467 (5th Cir. 1966) (interpretation of contract is question of law) *and* Dingman v. United States, 429 F.2d 70, 72 (8th Cir. 1970) (interpretation of contract not subject to clearly erroneous standard).

[66] *Compare* Dixon v. United States, 296 F.2d 556, 558 (8th Cir. 1961) (question whether master-servant relationship existed is question of fact) *with* Plomb Tool Co. v. Sanger, 193 F.2d 260, 264 (9th Cir. 1951), *cert. denied,* 343 U.S. 919 (1952) (conclusion by trial court that individual was servant is not subject to clearly erroneous rule).

[67] For a thorough discussion of the topic, see Weiner, *The Civil Nonjury Trial and the Law-Fact Distinction,* 55 CALIF. L. REV. 1020 (1967) and Weiner, *The Civil Jury Trial and the Law-Fact Distinction,* 54 CALIF. L. REV. 1867 (1966).

[68] WRIGHT & MILLER, *supra* note 27, at § 2589. *See* University Hills, Inc. v. Patton, 427 F.2d 1094, 1099 (6th Cir. 1970) (appellate court not bound by trial court's findings of mixed questions of law and fact); Shultz v. Wheaton Glass Co., 421 F.2d 259, 267 (3d Cir.) (same), *cert. denied,* 398 U.S. 905 (1970); Official Creditors' Committee for Fox Markets, Inc. v. Ely, 337 F.2d 461, 467 (9th Cir. 1964) (same), *cert. denied,* 380 U.S. 978 (1965). These cases have also referred to this issue as involving "legal inferences from the facts" or the "application of law to the facts." WRIGHT & MILLER, *supra* note 27, at § 2589.

[69] *See supra* note 53 and accompanying text.

[70] Since nearly any question involves at least *some* mixture of law and fact, the standard that "at least some legal reasoning" be involved is ambiguous at best. As already noted, the definitions of law and fact are two of the crucial difficulties inherent in application of rule 52(a). Because it is unlikely that anything better can be developed, the only hope is that the Supreme Court will see fit to make ad hoc determinations in borderline situations.

unclear. This doctrine is derived from the Supreme Court's decision in *Baumgartner v. United States*.[71] The issue in *Baumgartner* was whether the findings rendered by the lower courts met the clear and convincing standard of proof necessary to sustain a denaturalization decree.[72] In reversing, the Supreme Court stated that some findings of fact are appropriate subjects of appellate review:

> Finding so-called ultimate "facts" more clearly implies the application of standards of law. And so the "finding of fact" even if made by two courts may go beyond the determination that should not be set aside here. Though labeled "finding of fact," it may involve the very basis on which judgment of fallible evidence is to be made. Thus the conclusion that may be drawn from the whole mass of evidence is not always the ascertainment of the kind of "fact" that precludes consideration by this court. [cite omitted] . . . . Deference properly due to the findings of a lower court does not preclude the review here of such judgments. This recognized scope of appellate review is usually differentiated from review of ordinary questions of fact by being called review of a question of law, but that is often not an illuminating test and is never self-executing.[73]

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[71] 322 U.S. 665 (1944).

[72] *Id.* at 670. Baumgartner was accused of having sympathized with the Nazis, and of trying to influence others to do likewise. *Id.* at 666-70.

[73] 322 U.S. at 670-71. This seems to indicate that the Court confused an ultimate fact question with one involving a mixture of law and fact. The Court states that "[f]inding so-called 'ultimate' facts more clearly implies the application of standards of law." *Id.* at 670. The Court implies that it merely is attempting to give a more appropriate name to "borderline" cases when it states that "[t]his recognized scope of appellate review is usually differentiated from review of ordinary questions of fact by being called review of a question of law, but that is often not an illuminating test and is never self-executing." *Id.* at 671. Because mixed questions may be reviewed de novo, *see supra* note 68, this appellation, though confusing, would yield a correct result. Rule 52(a), however, has been interpreted to allow free review of findings of pure fact. *See infra* notes 82-95 and accompanying text.

Interestingly, the *Baumgartner* Court included a statement that tends to undercut rather than support the argument for free review of ultimate facts:

> The phrase "finding of fact" may be a summary characterization of complicated factors of varying significance for judgment. Such a "finding of fact" may be the ultimate judgment on a mass of details involving not merely an assessment of the trustworthiness of witnesses but other appropriate inferences that may be drawn from living testimony which elude print . . . .

322 U.S. at 670. The statement that the finding may involve factors deduced from the evidence that cannot be distilled from a printed transcript, which is all that is given to an appellate court, seems to imply that such a finding should be subjected to the clearly

The distinction between reviewability of "ultimate" and "subsidiary" facts was first set forth by a circuit court in *Lehmann v. Acheson*,[74] in which the Third Circuit relied on *Baumgartner* in holding that a finding that expatriation had taken place was one of ultimate fact.[75] At this point the ultimate fact doctrine was being applied to situations that apparently involved mixed questions of law and fact, that is consistent with *Baumgartner*.[76]

The Fifth Circuit considered the issue in *Galena Oaks Corp. v. Scofield*.[77] At issue in *Galena Oaks* was whether profit realized from the sale of houses should be treated as capital gains or ordinary income for federal income tax purposes.[78] The court relied on *Baumgartner* and *Lehmann* to support the proposition that ultimate facts may be reviewed de novo.[79] It is difficult to determine whether the court in *Galena Oaks* used the ultimate fact doctrine to review what was actually a mixed question of law and fact or used it to review de novo a finding of pure fact. The court decided that the district court erred by failing to consider, in addition to the purpose for which it was held at the time of sale, the purpose for which the property was held prior to sale.[80] Since it decided that the purpose for which the property was held at the time of sale was a fact (the ultimate fact to which the court refers), the prior purpose would seem to be a fact as well.[81] Because the Fifth Circuit subsequently affirmed the trial court's decision,[82] it delved no deeper. At the least, it seems fair to say that *Galena Oaks*

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erroneous rule because the trial court's opportunity to personally observe the testimony gives it an advantage over the appellate court in determining the weight to be given to the evidence. *See supra* note 41. The demeanor/documentary evidence issue is discussed in greater detail at *infra* notes 103-44 and accompanying text.

[74] 206 F.2d 592 (3d Cir. 1953).

[75] *Id.* at 594.

[76] The *Lehmann* court stated that an ultimate fact is a legal inference derived from other facts and therefore is not within the ambit of rule 52(a). *Id.* This indicates that the court may have used "ultimate fact" synonymously with "mixed question." *See supra* note 73.

[77] 218 F.2d 217 (5th Cir. 1954).

[78] *Id.* at 218.

[79] *Id.* at 219. The court cited *Lehmann*, 206 F.2d at 594, for this proposition. The Fifth Circuit also gave some indication that perhaps it considered ultimate facts merely to be mixed questions of law and fact by quoting Professor Moore: "Findings of fact that are induced by an erroneous view of the law are not binding. Nor are findings that combine both fact and law, when there is error as to the law." *Id.* at 219 (quoting from 5 J. MOORE, W. TAGGART, & J. WICKER, MOORE'S FEDERAL PRACTICE ¶ 52.03(3) (2d ed. 1976)).

[80] 218 F.2d at 220.

[81] *Id.*

[82] *Id.*

represents erosion of the ultimate fact doctrine toward de novo review of findings of pure fact.

The Fifth Circuit further progressed toward de novo review of findings of pure fact with its decision in *Industrial Instrument Corp. v. Foxboro Co.*[83] The court stated that a finding of fact may be reversed without application of the clearly erroneous standard when "the issue revolves around an ultimate fact question as distinguished from subsidiary fact questions, *or* where mixed questions of law and fact are presented when there is error as to the law."[84] Thus, the Fifth Circuit distorted the *Baumgartner* rule to allow de novo review of findings of pure fact. Further, the Fifth Circuit added the refinement that while "subsidiary"[85] facts are subject to the clearly erroneous rule, "ultimate"[86] facts are not.[87]

The ultimate fact doctrine has been illustrated especially well in a

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[83] 307 F.2d 783 (5th Cir. 1962). The case involved a finding of infringement of a patent. *Id.* at 784.

[84] *Id.* at 786 n.2 (emphasis added).

[85] Subsidiary facts have been defined as those entailing the "determination of an evidentiary or primary fact." East v. Romine, Inc., 518 F.2d 332, 338-39 (5th Cir. 1975). Ultimate facts "may involve the very basis on which judgment of fallible evidence is to be made." Baumgartner v. United States, 322 U.S. 665, 671 (1944).

[86] *See* Industrial Instrument Corp. v. Foxboro Co., 307 F.2d 783, 786 n.2 (5th Cir. 1962) (court distinguishes between ultimate and subsidiary facts for purposes of review). *See also* East v. Romine, Inc., 518 F.2d 332, 339 (5th Cir. 1975) (court may make independent finding of ultimate fact but is bound by lower court's finding of subsidiary fact unless clearly erroneous).

[87] This doctrine has been applied (and rejected) in other contexts as well. *Compare* J.B. Williams Co. v. Le Conte Cosmetics, Inc., 523 F.2d 187, 192 (9th Cir. 1975) (issue of trademark confusion is one of ultimate fact) *with* National Ass'n of Blue Shield Plans v. United Bankers Life Ins. Co., 362 F.2d 374, 376 (5th Cir. 1966) (finding of likelihood of confusion is finding of fact and therefore subject to rule 52(a)) *and* Beatrice Foods Co. v. Neosho Valley Coop. Creamery Ass'n, 297 F.2d 447, 449 (10th Cir. 1961) (whether trade names are confusing is question of fact subject to clearly erroneous standard). *See also* Stephens v. Arrow Lumber Co., 354 F.2d 732, 734 (9th Cir. 1966) (finding that equitable mortgage existed was finding of ultimate fact); Tomlinson v. Dwelle, 318 F.2d 60, 61 (5th Cir. 1963) (finding that income from sale of houses was capital gain is ultimate fact); Around the World Shoppers Club v. United States, 309 F.2d 324, 324 (3d Cir. 1962) (conclusion by lower court that sales occurred in United States for tax purposes was conclusion of ultimate fact); Cordovan Assocs., Inc. v. Dayton Rubber Co., 290 F.2d 858, 860 (6th Cir. 1961) (interpretation of contract was either question of law, mixed question of law and fact, or ultimate fact, and reviewable de novo); Steinbrugge v. Haddock, 281 F.2d 871, 872-73 (10th Cir. 1960) (question whether agency relationship exists is question of fact and may not be reversed unless clearly erroneous). Because the Fifth Circuit decisions on employment discrimination illustrate the doctrine so well, and because it was an employment discrimination case that was chosen by the Supreme Court for its ruling on ultimate fact, only this line will be explored in detail.

number of employment discrimination cases that have been decided by the Fifth Circuit.[88] The Fifth Circuit has developed a rule that considers intent to discriminate in an employment discrimination case to be an ultimate fact.[89] Thus, the court reviews findings of discriminatory

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[88] These cases also sharply define the Fifth Circuit's distinction between review of mixed questions and "ultimate" facts. In United States v. Jacksonville Terminal Co., 451 F.2d 418 (5th Cir. 1971), *cert. denied*, 406 U.S. 906 (1972), the Fifth Circuit cited Galena Oaks Corp. v. Scofield, 218 F.2d 217, 219-20 (5th Cir. 1954), for the proposition that a finding of ultimate fact does not have the clearly erroneous standard as "a bulwark hindering appellate review," and distinguished between ultimate facts and legal inferences derived from facts. 451 F.2d at 423-24. In Hester v. Southern Ry., 497 F.2d 1374 (5th Cir. 1974), the court concluded that the final determination in an employment discrimination case, intent, "is among the class of ultimate facts dealt with as conclusions of law and subject to review outside the constrictions of Rule 52(a)." 497 F.2d at 1381. Interestingly, the court had already determined that the district court's finding was clearly erroneous. *Id.* The court in Causey v. Ford Motor Co., 516 F.2d 416 (5th Cir. 1975), citing *Galena Oaks*, stated that, although essentially a finding of fact, a finding of discriminatory purpose was reviewable without regard to rule 52(a). *Id.* at 421.

In the next case in the line, East v. Romine, Inc., 518 F.2d 332 (5th Cir. 1975), the court cited the preceding cases in support of the premise that a finding of intent to discriminate in employment is a finding of ultimate fact and further refined the rule by stating that the court was entitled to "make an independent determination of appellant's allegation of discrimination although bound by findings of subsidiary fact which are not themselves clearly erroneous." *Id.* at 339.

The other circuits have split on the ultimate fact issue as it relates to findings of employment discrimination. The Seventh Circuit has followed the Fifth Circuit. Stewart v. General Motors Corp., 542 F.2d 445, 449 (7th Cir. 1976), *cert. denied*, 433 U.S. 919 (1977). Two of the circuits have expressly rejected the Fifth Circuit rule. *See* Kunda v. Muhlenburg College, 621 F.2d 532, 544 (3d Cir. 1980) (citing *Sweeney*); Sweeney v. Board of Trustees, 604 F.2d 106, 109 n.2 (1st Cir. 1979), *cert. denied*, 444 U.S. 1045 (1980) (applying the clearly erroneous standard to mixed questions of law and fact). The remaining circuits also have applied the clearly erroneous standard to findings of discriminatory purpose. *See, e.g.*, Agarwal v. McKee & Co., 644 F.2d 803, 806 (9th Cir. 1981); Bostic v. Boorstin, 617 F.2d 871, 875 n.18 (D.C. Cir. 1980), *cert. denied*, 449 U.S. 898 (1980); Silberhorn v. General Iron Works Co., 584 F.2d 970, 971 (10th Cir. 1978); EEOC v. Chesapeake & O. Ry., 577 F.2d 229, 233 (4th Cir. 1978); Duckett v. Silberman, 568 F.2d 1020, 1023 (2d Cir. 1978); Kendrick v. Comm'n of Zoological Subdistrict, 565 F.2d 524, 526-27 (8th Cir. 1977); Smith v. South Cent. Bell Tel. Co., 518 F.2d 68, 69 (6th Cir. 1975).

[89] At least two Fifth Circuit cases illustrate that the rule is not uniformly applied. In Van Ooteghem v. Gray, 628 F.2d 488 (5th Cir. 1980), *cert. denied*, 455 U.S. 909 (1982), an employee alleged that he was fired because he exercised his right to free speech. 628 F.2d at 490. Van Ooteghem, an asssistant county treasurer, informed his employer, the defendant, that he was a homosexual and that he planned to address the Commissioners Court regarding homosexuals. Gray informed Van Ooteghem that the latter was forbidden to leave his office between eight a.m. and five p.m., although previously he had been allowed to set his own hours. These times corresponded with those during which citizens were allowed to appear before the Commissioners Court. Upon his refusal to accede, Van

intent or purpose without the protection of the clearly erroneous standard. The final case in the line, *Swint v. Pullman-Standard*,[90] states all of the relevant doctrines relating to law and fact on review: that findings of fact may be set aside only if clearly erroneous;[91] that legal conclusions may be overturned without regard to rule 52(a);[92] and that discriminatory intent or purpose, the central issue in such a case, is an ultimate fact, and may be reviewed independently.[93] The court then applied the clearly erroneous standard as though it considered discrimination *vel non* to be a finding of pure fact.[94]

Ooteghem was dismissed. *Id.* at 490. The district court found that Van Ooteghem's speech was a substantial factor in his dismissal. *Id.* at 491. The Fifth Circuit stated that "[i]t is improper for an appellate court to subvert the clear mandate of Rule 52 by applying the phrase 'ultimate fact' to important factual questions or to the last factual determination in a given case, in order to justify 'plenary review' of an issue." *Id.* at 491-92. The court held that use of the ultimate fact doctrine should be limited to cases that at first appeared to have only involved questions of fact, but "actually require the application of a lurking legal standard to the predetermined facts of a case." *Id.* at 492. This decision would have returned the Fifth Circuit to the *Baumgartner* precedent. For a discussion of Baumgartner v. United States, 322 U.S. 665 (1944), see *supra* notes 71-73 and accompanying text. The court, however, determined that this case involved a pure fact, *id.* at 491, rendering the preceding passages mere dicta.

The second case, Humphrey v. Southwestern Portland Cement Co., 488 F.2d 691 (5th Cir.), *rehearing denied*, 490 F.2d 992 (1974), again involved discriminatory intent. 488 F.2d at 694. This case was reversed on the ground that the finding was an ultimate fact, but had no subsidiary facts to buttress it. *Id.* at 694. Without such support, the court ruled that the ultimate facts must be set aside as clearly erroneous. *Id.* Although at first glance it appears that the court applied rule 52 to a so-called ultimate fact in contravention of the Fifth Circuit rule, a careful reading reveals otherwise. The court merely applied the rule from Industrial Instrument Corp. v. Foxboro Co., 307 F.2d 783 (5th Cir. 1962), that without subsidiary facts, an ultimate fact cannot stand.

[90] 624 F.2d 525 (5th Cir. 1980), *rev'd and remanded*, 456 U.S. 273 (1982). This case was decided prior to *Van Ooteghem*, but because that case is a departure from the Fifth Circuit's traditional ultimate fact line and because the Supreme Court chose to use *Swint* to guide review of findings of ultimate fact back to *Baumgartner*, *Swint* will be treated as the last of the line.

[91] 624 F.2d at 533 n.6.

[92] *Id.*

[93] *Id.*

[94] *Id.* at 533. The district court applied the four factors used to determine purposeful discrimination in James v. Stockham Valves & Fittings Co., 559 F.2d 310 (5th Cir. 1977), *cert. denied*, 434 U.S. 1034 (1978). The Fifth Circuit analyzed the district court's findings on the factors and decided that an analysis of the "totality of the facts and circumstances" in existence during the period in which discrimination was alleged left it "with the definite and firm conviction that a mistake has been made." 624 F.2d at 533. The district court was unequivocally reversed as to three of the factors, 624 F.2d at 533, 535, and held to have applied the wrong burden of proof in the other. 624 F.2d at 530-31. It is submitted that at least three of these involved findings of fact. By citing

The Supreme Court dealt with the ultimate fact issue in its reversal of *Swint*.[95] The Court ruled that *if* the Fifth Circuit had applied the rule that "seems" to be the accepted rule therein concerning review of ultimate facts, then the Fifth Circuit had erred.[96] The Court conceded that the Fifth Circuit may have applied the law correctly by using the ultimate fact rule merely as another means for determining a mixed question of law and fact.[97] The Court expressly overturned the Fifth Circuit's line of cases based on *Baumgartner*, stating that *Baumgartner*'s reference to ultimate facts did not include pure findings of fact and thus did not allow de novo review by an appellate court any time the case before it hinged on a finding of fact.[98] The Court emphasized the message by stating that rule 52 "does not make exceptions or purport to exclude certain categories of factual findings from [the clearly erroneous standard]. It does not divide facts into categories; in particular, it does not divide findings of fact into those that deal with ultimate and those that deal with subsidiary facts."[99]

Thus, it seems that although the Court may have chosen a poor case as the vehicle, use of the *Baumgartner* ultimate fact doctrine to freely review findings of pure fact has been abolished. And rightly so; a fact is a fact. The rule makes no distinction. Appellate judges should look to the considerable case law[100] and the *Lundgren* test[101] to distinguish between questions of fact, questions of law, and mixed questions, and rule accordingly without attempting to bend the law to suit their perception of the desired result in the particular cases before them for review.

B. Findings of Fact from Documentary or Undisputed Evidence

The deference to be accorded findings of fact that have as their bases documentary or undisputed evidence is another center of contro-

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both the clearly erroneous rule and the ultimate fact doctrine, the Fifth Circuit left doubt as to its grounds for reversal. The writer submits that the court cited the two rules alternatively.

[95] Pullman-Standard v. Swint, 456 U.S. 273, 287-90 (1982).

[96] *Id.* at 286. For the purposes of this comment, because the Supreme Court overturned the Fifth Circuit rule, a determination of the exact application used by the Fifth Circuit in *Swint* is not crucial.

[97] *Id.* at 286 n.16. This, of course, would mean that the Fifth Circuit had correctly applied *Baumgartner* as it later did in *Van Ooteghem*. *See supra* note 88.

[98] 456 U.S. 289-90.

[99] *Id.* at 287.

[100] This may be of little assistance. *See supra* notes 64-67 and accompanying text.

[101] *See supra* notes 61-63 and accompanying text.

versy concerning rule 52.[102] The argument is the result of friction between the wording of the rule itself and the comment appended thereto. The rule states that "[f]indings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."[103] It would seem from the wording of the rule that because the conjunction "and" precedes the clause concerning the trial court's opportunity to decide the credibility of the witnesses that the clearly erroneous standard is made more stringent when the trial court has had the opportunity to observe the presentation of evidence by witnesses.[104] There is nothing in the rule that allows an appellate court to more freely review a lower court's findings when the trial judge has *not* had an opportunity to judge the witnesses' credibility. Indeed, this is the position taken by some appellate judges[105] and writers,[106] and is the manifest

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[102] Compare the cases cited *infra* note 105 with those cited *infra* notes 112 and 121.

[103] FED. R. CIV. P. 52(a).

[104] *See* Wright, *supra* note 51, at 769-70.

> "If the word 'and' means anything, it must mean that these are two separate restrictions being placed on appellate review of findings. . . . That Rule 52 required application of the clearly erroneous standard to all findings, regardless of the nature of evidence, should thus have been apparent to anyone who understands the difference between a hypothetical and a conjunctive proposition.

Id. at 769-70.

See also WRIGHT & MILLER, *supra* note 27, at § 2586 (citing Graver Tank & Mfg. Co. v. Linde Air Prods. Co., 336 U.S. 271, 275 (1949), and other cases).

[105] The First, Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth, and District of Columbia Circuits have applied the clearly erroneous standard to findings based upon all types of evidence. *See, e.g.*,

First Circuit: Merrill Trust Co. v. Bradford, 507 F.2d 467, 468 (1st Cir. 1974); Leach v. Crucible Center Co., 388 F.2d 176, 179 (1st Cir. 1968); Texas Co. v. R. O'Brien & Co., 242 F.2d 526, 529 (1st Cir. 1957).

Second Circuit: Lamont v. Commissioner, 339 F.2d 377, 380-81 (2d Cir. 1964); Weddle v. Commissioner, 325 F.2d 849, 851 (2d Cir. 1963); Austin v. Commissioner, 298 F.2d 583, 585 (2d Cir. 1962).

Fourth Circuit: Piedmont Minerals Co. v. United States, 429 F.2d 560, 562 (4th Cir. 1970); Nalle v. First Nat'l Bank, 412 F.2d 881, 884 (4th Cir. 1969); Prendis v. Central Gulf S.S. Co., 330 F.2d 893, 895 (4th Cir. 1963).

Fifth Circuit: United States v. Florida, 482 F.2d 205, 207-08 (5th Cir. 1973); United States *ex rel.* Citizens Nat'l Bank v. Stringfellow, 414 F.2d 696, 699 (5th Cir. 1969); Sicula Oceanica, S. A. v. Wilmar Marine Eng. & Sales Corp., 413 F.2d 1332, 1334 (5th Cir. 1969).

Sixth Circuit: H. K. Porter Co. v. Goodyear Tire & Rubber Co., 437 F.2d 244, 246 (6th Cir.), *cert. denied*, 404 U.S. 885 (1971); General Elec. Co. v. Sciaky Bros., Inc., 415 F.2d 1068, 1071 (6th Cir. 1969); United States Steel Co. v Fuhrman, 407 F.2d 1143, 1145-46 (6th Cir. 1969), *cert. denied*, 398 U.S. 958 (1970).

intent of the drafters of the rule.[107]

Seventh Circuit: Indiana State Employees Ass'n v. Negley, 501 F.2d 1239, 1241-42 (7th Cir. 1974); A.L.B. Theatre Corp. v. Loew's Inc., 355 F.2d 495, 499 (7th Cir. 1966); McGowan v. Commissioner, 347 F.2d 728, 729 (7th Cir. 1965).

Eighth Circuit: Worthen Bank & Trust Co. v. Franklin Life Ins. Co., 370 F.2d 97, 99-100 (8th Cir. 1966); Lewis v. Super Valu Stores, 364 F.2d 555, 556 (8th Cir. 1966).

Ninth Circuit: Purer & Co. v. Aktiebolaget Addo, 410 F.2d 871, 877-78 (9th Cir.), *cert. denied*, 396 U.S. 834 (1969); Stauffer Labs, Inc. v. FTC, 343 F.2d 75, 78 (9th Cir. 1965); Truck Terminals, Inc. v. Commissioner, 314 F.2d 449, 455 (9th Cir. 1963).

Tenth Circuit: Quarles v. Fuqua Ind., Inc., 504 F.2d 1358, 1361 (10th Cir. 1974); *In re* Sierra Trading Corp., 482 F.2d 333, 336 (10th Cir. 1973); United States v. Goldfield Corp., 384 F.2d 669, 671 (10th Cir. 1967).

District of Columbia Circuit: Case v. Morrisette, 475 F.2d 1300, 1306 (D.C. Cir. 1973); Bishop v. United States, 223 F.2d 582, 586-87 (D.C. Cir. 1955), *vacated and remanded on other grounds*, 350 U.S. 961 (1956).

See also WRIGHT & MILLER, *supra* note 27, § 2587 at 745-47 n.33. It should be noted that some of the circuits listed above at times have applied the rule differently. *See infra* note 121.

[106] *See* WRIGHT & MILLER, *supra* note 27, § 2586; Clark, *Special Problems in Drafting and Interpreting Procedural Codes and Rules*, 3 VAND. L. REV. 493, 505-06 (1950); Wright, *supra* note 51, at 769-71.

[107] The original Committee had proposed three possible systems for review:

> The first is to retain the present system of review, viz., that in jury-waived cases, the findings of fact shall have the same effect as the verdict of a jury in an action at law; while in equity cases, the findings of fact are reviewable as to the weight of the supporting evidence as well as the sufficiency . . . . The second solution is to provide that the findings of fact in all cases should be reviewed in the same way, and that they should have the same effect as the verdict of a jury . . . . The third is the system here proposed in Rule 68 [Rule 52(a)], whereby the review in jury-waived cases is made that of the equity practice, thus leaving all cases tried without a jury to be fully reviewed upon appeal.

NOTE TO THE SUPREME COURT, PRELIMINARY DRAFT, FEDERAL RULES OF CIVIL PROCEDURE 120-21 (1936).

The Committee adopted the third proposal with Dean Charles Clark, reporter for the committee, objecting. *See supra* note 41. The first proposal was rejected because it did nothing to abolish the procedural distinctions between law and equity review. NOTE TO THE SUPREME COURT, PRELIMINARY DRAFT, FEDERAL RULES OF CIVIL PROCEDURE 120 (1936). The second was rejected for no recorded reason. *Id.* The Committee gave as its grounds for adopting the third proposal that it "fulfills the mandate of the statute, while also abolishing the ancient procedural distinctions between review for natural division which leaves the jury trial intact, but leaves all other trials subject to complete review." *Id.* at 121.

The word "complete" was deleted from the final draft, thereby indicating that the drafters intended the rule to be a compromise between de novo review espoused by Professor Blume and restricted review favored by Dean Clark. *See supra* note 41.

The original note submitted by the Advisory Committee to indicate its intent stated: "It is applicable to all classes of findings in cases tried without a jury whether the finding is of a fact concerning which there was a conflict of testimony, or of a fact deduced or

Because the comment to the rule, however, states that it "accords with modern federal equity practice,"[108] and because, as one writer put it, "for litigants the pudding is the payoff, and not the cook's intent,"[109] the effect of the rule has been weakened by interpretation. This construction of rule 52(a), called the "gloss" approach,[110] applies the clearly erroneous standard as if the two clauses were joined by the conjunction "if," rather than "and."[111] Adherents to this interpretation would apply the clearly erroneous rule to all findings of fact unless they are based on documentary or undisputed evidence, in which case it is argued that the trial court has no advantage over the appellate court.[112] Although even its opponents concede that the gloss is harm-

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inferred from uncontradicted testimony." NOTE TO THE SUPREME COURT, PRELIMINARY DRAFT, FEDERAL RULES OF CIVIL PROCEDURE 120-21 (1936). Alarmed at the direction taken by the judicial decisions, the Advisory Committee again expressed its intent in a proposed amendment to the rule in 1955: "Findings of fact shall not be set aside unless clearly erroneous. In the application of this principle, regard shall be given to the special opportunity of the trial court to judge of the credibility of the witnesses." REPORT OF PROPOSED AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE FOR UNITED STATES DISTRICT COURTS 51 (1955). The committee added as a note:

> The amendment is designed to end the confusion and show definitely that the "clearly erroneous" test is not modified by the language which formerly followed it, but is applicable in all cases. The separate provision that regard must be given to the trial court's opportunity to judge the credibility of witnesses who appeared personally emphasizes only the special reluctance which must be felt in holding clearly erroneous a finding based on oral testimony.

ADVISORY COMMITTEE NOTE OF 1955 TO PROPOSED (BUT UNADOPTED) AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE, *reprinted in* MOORE, *supra* note 11, ¶ 52.01[7], at 2609-10.

The Committee has also proposed another amendment to rule 52 that makes its position even more clear. The rule would be amended to state that "[f]indings of fact, *whether based on oral or documentary evidence*, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses *and to the need for finality*." PRELIMINARY DRAFT OF PROPOSED AMENDMENTS TO THE FEDERAL RULES OF CIVIL PROCEDURE 5 (1983) (emphasis in original). The Committee note following the new proposal explicitly rejects all interpretations of the rule but the strict approach. *Id.* at 6-7. The Committee based its decision upon substantially the same grounds given by Dean Clark: that the public interest in stability and judicial economy would be better served by establishing that the trial court is the trier of fact. To allow appellate courts to impinge upon that authority would "tend to undermine the legitimacy of the district courts in the eyes of litigants, multiply appeals by encouraging appellate retrial of some factual issues, and needlessly reallocate judicial authority." *Id.* at 7. *See also supra* note 41.

[108] FED. R. CIV. P. 52(a) advisory committee notes.

[109] MOORE, *supra* note 11, at ¶ 52.04.

[110] The term was coined by Judge Clark. *See* Clark, *supra* note 106, at 505.

[111] *See* Wright, *supra* note 51, at 769-70.

[112] *See, e.g.*,

less,[113] or is even a "sound" gloss,[114] if there is no support for such interpretation or no compelling reason to use it, then it should be abandoned.

"Modern federal equity practice" is, at best, an uncertain guideline for the ambit of appellate review. While some assert that appellate equity courts imposed restrictions upon themselves[115] so that their discretion on review did not encompass findings based upon documentary or undisputed evidence,[116] others contend that "modern federal equity

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First Circuit: Fleming v. Palmer, 123 F.2d 749, 751 (1st Cir.), *cert. denied*, 316 U.S. 662 (1941).

Third Circuit: Ball v. Paramount Pictures, Inc., 169 F.2d 317, 318 (3rd Cir. 1948).

Fifth Circuit: United States *ex rel* Citizens Nat'l Bank v. Stringfellow, 414 F.2d 696, 699 (5th Cir. 1969); Pennsylvania Thresherman & Farmers' Mut. Cas. Ins. Co. v. Crapet, 199 F.2d 850, 853 (5th Cir. 1952).

Sixth Circuit: A.J. Indus., Inc. v. Dayton Steel Foundry Co., 394 F.2d 357, 361-62 (6th Cir. 1968).

Seventh Circuit: Best Medium Pub. Co. v. National Insider, Inc., 385 F.2d 384, 386 (7th Cir. 1967), *cert. denied*, 390 U.S. 955 (1968).

Eighth Circuit: State Farm Mut. Auto. Ins. Co. v. Bonacci, 111 F.2d 412, 415 (8th Cir. 1940).

Ninth Circuit: Haggard v. Wood, 298 F.2d 24, 25 (9th Cir. 1961); Smyth v. Barneson, 181 F.2d 143, 144 (9th Cir. 1950); Smith v. Royal Ins. Co., 125 F.2d 222, 224 (9th Cir.), *cert. denied*, 316 U.S. 695 (1942); Equitable Life Assur. Soc'y v. Irelan, 123 F.2d 462, 464 (9th Cir. 1941).

[113] *See* Clark, *Special Problems in Drafting and Interpreting Procedural Codes and Rules*, 3 VAND. L. REV. 493, 505 (1950) (gloss perhaps is not harmful, although to add discretion to a rule calling for the exercise of discretion was "gilding the lily"); Wright, *Amendments to the Federal Rules: The Function of a Continuing Rules Committee*, 7 VAND. L. REV. 521, 534 (1954) (gloss is reasonably justified).

[114] Wright, *supra* note 51, at 764.

[115] One such restriction was that the trial court's findings of fact would not be set aside unless clearly erroneous, for the reason that the trial judge has had the opportunity to observe the demeanor of the witnesses and judge their credibility. *See* United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948).

According to some writers, there was another self-imposed limitation that distinguished between conflicting and undisputed evidence, allowing greater deference to findings involving disputed evidence. Clark & Stone, *supra* note 7, at 208, 208 n.83. Also, this probably was the understanding of the drafters. The deletion of the word "complete" from the comment, *see supra* note 107, as well as the changes between proposed rule 68 and rule 52 evidence this. *Compare* rule 68 (quoted *supra* note 107) *with* FED. R. CIV. P. 52(a).

The last such restriction is said to have accorded greater deference to findings based upon real evidence given in open court than to findings based upon oral evidence. *See* Kaesar & Blair, Inc. v. Merchants' Ass'n, 64 F.2d 575, 576 (6th Cir. 1933); Equitable Life Assurance Soc'y v. Irelan, 123 F.2d 462, 464 (9th Cir. 1941); *see also infra* note 118.

[116] *See* Note, *Rule 52(a): Appellate Review of Findings of Fact Based on Documentary or Undisputed Evidence*, 49 VA. L. REV. 506, 515 n.50 (1960). The writer cites Clark

practice" allowed greater deference when the evidence was oral or contradictory but did not allow the clearly erroneous standard to be diluted when the evidence was documentary or undisputed.[117] It is difficult to ascertain the better view by examining such diametrically opposed interpretations of the same ethereal evidence. Perhaps the surest course is to take Judge Pound's position that there is support for both alternatives,[118] and that the modern federal equity practice standard therefore offers no meaningful guidance.[119]

Once this "harmless" gloss became established, it was a short leap of logic for courts to begin ignoring rule 52 and reasoning from the gloss.[120] By this interpretation, an appellate court may completely ignore the trial court's findings of fact and review the evidence de novo *unless* the lower court's findings were based on oral or disputed evidence.[121]

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and Stone, *supra* note 7, at 208, for this proposition. Clark and Stone offer no support for this contention. Rather, they state the well-accepted principle of equity practice that when the lower court's findings are based upon oral or conflicting evidence, the findings are entitled to greater deference than if they were not, which lends support to those who would strictly apply the rule as written. *See* Clark & Stone, *supra* note 7, at 207-08.

[117] *See* Wright, *supra* note 51, at 765; Clark & Stone, *supra* note 7, at 207-08.

[118] Faulkner v. Sims, 68 Neb. 299, 300-01, 94 N.W. 113, 114 (1903).

[119] *See* Nangle, *The Ever Widening Scope of Fact Review in Federal Appellate Courts - Is the "Clearly Erroneous Rule" Being Avoided?*, 59 WASH. U.L.Q. 409, 412 (1981) (scope of review at equity not entirely clear); Wright, *supra* note 51, at 768 (standard is so confusing it should not be used).

[120] *See* WRIGHT & MILLER, *supra* note 27, at § 2587 (courts began to reason from the gloss); Clark, *supra* note 106, at 505-06 (scope of review was extended from gloss "by a process almost inveterate in legal reasoning").

[121] Note, *supra* note 3, at 75-76. *See, e.g.*,

First Circuit: Fleming v. Palmer, 123 F.2d 749, 751 (1st Cir.), *cert. denied*, 316 U.S. 662 (1941).

Second Circuit: Agrashell, Inc. v. Bernard Sirotta Co., 344 F.2d 583, 589 (2d Cir. 1965); Oil Transp. Corp. v. Amboy Towboat, Inc., 193 F.2d 264, 265-66 (2d Cir. 1952); Eastern Wine Corp. v. Winslow-Warren, Ltd., 137 F.2d 955, 959-60 (2d Cir.), *cert. denied*, 320 U.S. 758 (1943).

Third Circuit: Borden Co. v. Clearfield Cheese Co., 369 F.2d 96, 101 (3d Cir. 1966); Soles v. Franzblau, 352 F.2d 47, 50 (3d Cir. 1965), *cert. denied*, 383 U.S. 911 (1966); Lehmann v. Acheson, 206 F.2d 592, 594 (3d Cir. 1953).

Fourth Circuit: Tidewater Patent Dev. Co. v. Kitchen, 371 F.2d 1004, 1006 (4th Cir.), *cert. denied*, 389 U.S. 821 (1967).

Fifth Circuit: Frazier v. Alabama Motor Club, Inc., 349 F.2d 456, 458 (5th Cir. 1965); Stubbs v. Fulton Nat'l Bank, 146 F.2d 558, 560 (5th Cir.), *cert. denied*, 325 U.S. 864 (1945); Stewart v. Ganey, 116 F.2d 1010, 1013 (5th Cir. 1940).

Sixth Circuit: National Latex Prods. Co. v. Sun Rubber Co., 274 F.2d 224, 247 (6th Cir. 1959), *rehearing denied*, 276 F.2d 167 (6th Cir.), *cert. denied*, 362 U.S. 989 (1960); E.H. Sheldon & Co. v. Commissioner, 214 F.2d 655, 658-59 (6th Cir. 1954); Seagrave

Perhaps the most extreme example of this position is the case of *Orvis v. Higgins*,[122] which involved decedent's intent in creating trusts.[123] Most of the testimony was undisputed.[124] The late Judge Jerome N. Frank, stating that he differed not with the trial court's estimation of the witnesses' credibility but with the inferences drawn from the evidence, delineated seven narrowly defined classes of cases.[125] Judge Frank postulated a sliding scale for review: the greater the trial court's reliance on oral or disputed evidence, the more deference the appellate court should give the trial court's findings of fact.[126] Judge

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Corp. v. Mount, 212 F.2d 389, 394 (6th Cir. 1954).

Seventh Circuit: Nickerson v. Commissioner, 700 F.2d 402, 405-06 (7th Cir. 1983); Nasco, Inc. v. Vision-Wrap, Inc., 352 F.2d 905, 908 (7th Cir. 1965); Welsh Co. v. Chernivsky, 342 F.2d 586, 588 (7th Cir.), *cert. denied*, 382 U.S. 842 (1965); Carter Oil Co. v. McQuigg, 112 F.2d 275, 279 (7th Cir. 1940).

Eighth Circuit: United States v. Kavanagh, 308 F.2d 824, 828 (8th Cir. 1962); United States v. Mississippi Valley Barge Line Co., 285 F.2d 381, 388 (8th Cir. 1960).

Ninth Circuit: Carter-Wallace, Inc. v. Procter & Gamble Co., 434 F.2d 794, 799 (9th Cir. 1970); Rollingwood Corp. v. Commissioner, 190 F.2d 263, 265 (9th Cir. 1951); Pacific Portland Cement Co. v. Food Mach. & Chem. Corp., 178 F.2d 541, 548 (9th Cir. 1949).

Tenth Circuit: Blackner v. McDermott, 176 F.2d 498, 502 (10th Cir. 1949); Bowles v. Beatrice Creamery Co., 146 F.2d 774, 780 (10th Cir. 1944).

District of Columbia Circuit: Perry v. Perry, 190 F.2d 601, 602 (D.C. Cir. 1951); Dollar v. Land, 184 F.2d 245, 249 (D.C. Cir.), *cert. denied*, 340 U.S. 884 (1950).

[122] 180 F.2d 537 (2d Cir. 1950).

[123] *Id.* at 540.

[124] *Id.*

[125] *Id.* at 541.

[126] *Id.* at 539-40. Judge Frank stated:

> In the light of the *Gypsum* case, we may make approximate gradations as follows: We must sustain a general or a special jury verdict when there is some evidence which the jury might have believed, and when a reasonable inference from that evidence will support the verdict, regardless of whether that evidence is oral or by deposition. In the case of findings by an administrative agency, the usual rule is substantially the same as that in the case of a jury, the findings being treated like a special verdict. Where a trial judge sits without a jury, the rule varies with the character of the evidence: (a) If he decides a fact issue on written evidence alone, we are as able as he to determine credibility, and so we may disregard his finding. (b) Where the evidence is partly oral and the balance is written or deals with undisputed facts, then we may ignore the trial judge's finding and substitute our own, (1) if the written evidence or some undisputed fact renders the credibility of the oral testimony extremely doubtful, or (2) if the trial judge's finding must rest exclusively on the written evidence or the undisputed facts, so that his evaluation of credibility has no significance. (c) But where the evidence supporting his finding as to any fact issue is entirely oral testimony, we may disturb that finding only in the most unusual circumstances.

Id. (citations omitted).

Chase, in dissent, argued that the clearly erroneous standard should have been applied.[127]

The Supreme Court has strictly applied the clearly erroneous standard in all cases, regardless of the type of evidence. In the seminal Supreme Court case, *United States v. United States Gypsum Co.*,[128] the Court made clear that review of findings of fact that are inferences drawn from documentary evidence or undisputed facts is within the scope of rule 52(a).[129] This removes the prop on which Judge Frank balanced his *Orvis* decision — that because he disagreed not with the trial court's estimation of the witnesses' credibility but with the inferences the trial judge had drawn from the facts, he was free to reverse.[130] This principle was reiterated in *Graver Tank & Manufacturing Co. v. Linde Air Products Co.*,[131] which hinged upon a determination of degree of equivalency between two trademarks.[132] The Court ruled that a finding of fact "is to be decided by the trial court and that court's decision, under general principles of appellate review, should not be disturbed unless clearly erroneous."[133] The Court added that the standard of review was made more strict because the findings were based upon oral testimony.[134] This same line of reasoning has been followed in *United States v. Oregon State Medical Society*,[135] *Commissioner v. Duberstein*,[136] and *United States v. Singer Manufacturing Co.*[137]

The attitude of the Court was made less clear in 1966, but does not seem to have changed. In *United States v. General Motors*

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[127] *Id.* at 521-42 (Chase, J., dissenting).

[128] 333 U.S. 364 (1948).

[129] *Id.* at 394.

[130] *See supra* text accompanying note 125.

[131] 339 U.S. 605 (1950).

[132] *Id.* at 608.

[133] *Id.* at 610.

[134] *Id.* at 611.

[135] 343 U.S. 326 (1952). The United States was directly appealing a district court judgment on its allegations of violation of the Sherman Act. *Id.* at 328. After declining to decide the issues de novo, the Court stated that because the testimony was, for the most part, oral and disputed, "there is no case more appropriate for adherence to [rule 52(a)]." *Id.* at 332. *See also* United States v. Yellow Cab Co., 338 U.S. 338, 341-42 (1949) (court accepted trial court findings because of ability of trier of fact to see and hear witnesses).

[136] 363 U.S. 278 (1960). The Court cited *U.S. Gypsum* as support for the premise that rule 52(a) applies to findings of fact inferred from undisputed facts. 363 U.S. at 291.

[137] 374 U.S. 174 (1963). Again, the Court stated the *U.S. Gypsum* rule that the clearly erroneous standard must be applied to factual inferences based on documentary evidence or undisputed facts. 374 U.S. at 194 n.9.

Corp.,[138] Justice Fortas may have indicated some support for the gloss approach by stating that "the trial court's customary opportunity to evaluate the demeanor and thus the credibility of the witnesses, which is the rationale behind Rule 52(a) [citations omitted] plays only a restricted role here. This was essentially a 'paper case.' "[139] This could conceivably be an expansion of the standard because the evidence is documentary, but it is just as likely that Justice Fortas meant that because the evidence was documentary, there was no reason to restrict the standard; this is the strict approach as applied in the preceding Supreme Court cases. At any rate, because it was determined that the trial court's error was the misapplication of a legal standard, rather than an incorrect factual finding,[140] this statement is pure dictum.

In his dissent to *Pullman-Standard v. Swint*,[141] Justice Marshall argued that the gloss approach is the correct one.[142] Because Justice Marshall was joined by only one other Justice,[143] it seems unlikely that the Court will switch from strict application of the rule as written any time soon.

Thus, it is apparent that the correct approach to cases involving documentary evidence or undisputed facts is strict application of rule 52(a) as written. There is no support at all for Judge Frank's system of de novo review for such cases: not in the rule itself, the comment, the drafters' intent, or in the Supreme Court's rulings. The gloss approach, while perhaps more palatable, is equally without foundation. Though there is some doubt as to the prevailing "modern federal equity practice," there is no uncertainty in the provisions of the rule itself, the intent of the drafters, or the interpretation of the rule by the Supreme Court.

Conclusion

It is unfortunate that some imprecise language in an explanatory note and some appellate judges' reluctance to yield any authority has caused a straight-forward provision to become a morass of confusion.

Rule 52(a) clearly states that findings of fact in federal nonjury cases shall be set aside only if clearly erroneous. Because this is a fairly

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[138] 384 U.S. 127 (1966).

[139] *Id.* at 142 n.16.

[140] *Id.* at 142, 142 n.16.

[141] 456 U.S. 273, 293 (1982) (Marshall, J., dissenting).

[142] *Id.* at 302, 302 n.7.

[143] Justice Marshall was joined by Justice Blackmun except in Part I of the dissent. *Id.* at 293.

stringent test and because appellate judges are careful not to intentionally misapply it, various methods of entirely circumventing the rule have arisen. These include calling findings of fact findings of law,[144] or calling them ultimate facts,[145] or modifying the rule in cases of documentary or undisputed evidence.[146] As previously stated, the only support in the rule or related materials for any of these devices is the reference to "modern federal equity practice" in the advisory note to rule 52(a).[147]

Simply stated, this standard is ambiguous. Even if it were pellucid, however, there is no justification whatever for allowing an advisory note to a Federal Rule of Civil Procedure to supersede and circumvent the plain language of the rule and clear intent of those who drafted it.[148] Because ambiguity in the advisory note has provided a pretext for misapplication of the rule, clearly the advisory note should be revised.

The 1983 proposed amendment to rule 52(a), which explicitly extends the clearly erroneous standard to *all* findings of fact, should be enacted forthwith.[149] This would eliminate any justification for use of the nebulous equity practice guideline and all the troublesome baggage it carries with it. It would be clear that all types of findings of pure fact in all cases, no matter what type of evidence the findings are based upon, are to be overturned only if they are clearly erroneous. The present confused state of affairs in a very real sense renders district judges superfluous. Because findings of law rendered by district courts may presently be freely reviewed, to allow free review of findings of fact can render a trial in district court a waste of time and money, because the appellate court may review *every* element of the case. The clearly erroneous standard already gives the appellate court all the discretion necessary to correct erroneous factual findings. When the *U.S. Gypsum* standard has been met, the appellate court may overturn a finding of fact without resort to circumvention of rule 52(a).

As stated by Professor Blume, who favored free review, "The court should be able to look at the result in the light of the evidence to see that justice has been done. To do this, the reviewing court must have power to review the facts as well as the law."[150] The clearly erroneous

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[144] *See supra* notes 57-60 and accompanying text.

[145] *See supra* notes 71-95 and accompanying text.

[146] *See supra* notes 102-43 and accompanying text.

[147] *See supra* notes 108-19 and accompanying text.

[148] *See supra* note 107.

[149] *Id.*

[150] Blume, *Review of Facts in Jury Cases—The Seventh Amendment*, 20 J. AM. JUD. SOC'Y 130, 132 (1936).

standard of rule 52(a) gives the reviewing court sufficient discretion to do this. This standard is a fair compromise between the opportunity of the trial court to personally observe the testimony and evidence presented before it and the extra time that the appellate court has to reflect upon the record.

John R. Branson

AN OVERVIEW OF MISSISSIPPI'S CONSTRUCTION ARBITRATION ACT

INTRODUCTION

Arbitration is a form of dispute resolution that has not been widely used in Mississippi. The mechanism has been recognized by statute in this state since before the turn of the century,[1] but appears to have found little favor as a means of settling disagreements.[2] As a result of unfamiliarity resulting from this lack of use, many attorneys probably are hesitant to engage in arbitration proceedings. There are many factors to consider when determining whether to employ arbitration to settle a conflict, but its historical lack of use should not be one of them. Recent legislation may make the process more appealing for dispute resolution in one area of frequent litigation.

In 1981, the Mississippi Legislature enacted a law that makes agreements to arbitrate construction contracts and related disputes enforceable in the state courts.[3] Before this measure was enacted, a construction-related claim that did not fall within the Federal Arbitration Act[4] was usually decided by two of the three typical methods of dispute resolution: litigation or negotiation and settlement. The 1981 leg-

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[1] *See* MISS. CODE §§ 95-113 (1892) (current codification at MISS. CODE ANN. §§ 11-15-1 to -37). The goal of arbitration, as recited by the statutes, is to settle disputes and prevent litigation. *Id.* § 11-15-37.

[2] Between 1892 and 1982, the Mississippi Supreme Court referred to these arbitration statutes approximately 9 times, a fact indicating that the process was seldom employed.

There are a number of plausible explanations for the infrequent use of arbitration. The statutes provide only for arbitration of existing controversies, and do not mention agreements concerning future disputes. *See* MISS. CODE ANN. § 11-15-1 (1972) (parties may submit to arbitrators a controversy *existing* between them). The statutes have been held not to change the common-law rule that a party can revoke an arbitration agreement at any time before an award is made. McClendon v. Shutt, 237 Miss. 703, 706-07, 115 So. 2d 740, 741 (1959). Further, the statutes provided that arbitration awards be confirmed judicially. *See* MISS. CODE ANN. § 11-15-21 (1972) (setting out procedure for confirmation).

[3] MISS. CODE ANN. §§ 11-15-101 to -143 (Supp. 1982).

[4] Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1976). This Act provides procedures for enforcement of written arbitration provisions in contracts "affecting commerce," with the exception of "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." *Id.* §§ 1-2. For a discussion of jurisdiction under the Federal Act, see *infra* notes 94-96 and accompanying text.

islation makes the third method, arbitration, useful as well.[5] Under the provision, parties to a construction-related contract may agree to submit existing or future disputes to arbitration, and this agreement will be enforced in the courts of Mississippi.[6]

Although arbitration is not the answer in all cases, it is often the better means for settling a disputed claim.[7] Since arbitration is an uncharted course for many Mississippi attorneys, this comment will deal with the basic provisions of the new statute and their anticipated effect. This discussion necessarily will incorporate a general explanation of arbitration and its relative benefits as a means of dispute resolution.

I. Major Features of the Construction Arbitration Act

A. Scope

The legislature defined the scope of Mississippi's Construction Arbitration Act[8] to include any agreement made after July 1, 1981, "for the planning, design, engineering, construction, erection, repair or al-

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[5] The usefulness of arbitration has gained recognition as the courts have become increasingly unsuitable for resolving many construction disputes. Arbitration is generally a faster method than litigation; the vast majority of construction cases handled by the American Arbitration Association (AAA) are resolved within six to nine months. The costs are usually moderate compared to litigation, and the procedure is more flexible. Hoellering, *Arbitration and Mediation: the Modern Approach to Resolving Construction Disputes,* in Construction Arbitration: Selected Readings 2-3 (1981).

The frequency with which arbitration is used is reflected by the case-load of the American Arbitration Association. During 1979, some 2,650 construction disputes involving total claims of $175,314,945, were filed under the AAA's Construction Industry Arbitration Rules. *Id.* See *infra* note 21.

[6] *See* Miss. Code Ann. § 11-15-103 (Supp. 1982) (written agreement to submit existing or future controversies to arbitration will be enforceable and irrevocable). Concerning the enforceability of arbitration agreements under Mississippi's general arbitration statutes, see *supra* note 2.

[7] In determining whether arbitration is the "best" means for the resolution of a dispute, a number of factors should be taken into account. This analysis should begin at the contract formation stage, as the parties determine whether an arbitration clause should be included in the contract. The size of the project, number of parties involved, relationships among the parties, and potential areas of dispute should be considered. Naturally the preference of the parties is also a factor which plays a very practical role in the decision. For guidance in large projects, see Golembiewski, Miller & Trattner, *Designing an Arbitration System for a Mass Transportation Construction Project,* Arb. J., Sept. 1979, at 14, which deals with problems and solutions involved in construction of the Metropolitan Atlanta Rapid Transit Authority.

[8] Miss. Code Ann. §§ 11-15-101 to -143 (Supp. 1982). The title of the act as codified is: "Arbitration of Controversies Arising from Construction Contracts and Related Agreements." For convenience it is referred to as the "Construction Arbitration Act."

teration of the building, structure, fixture, road, highway, utility or part thereof, and . . . any purchase by, or supply to, any contractor or subcontractor qualified to do business in this state of any materials to be used in the planning, design, engineering, construction, erection, repair or alteration of any building, ..."[9] The Act specifically applies to "architectural, engineering, surveying, planning and related professional services . . ."[10] performed as part of an agreement covered by the Act. This broad language clearly expresses an intent to bring all aspects of the construction and repair of buildings within the provisions of the Act. Arbitration agreements within the scope of the Act may be enforced whether the dispute existed at the time of the agreement or arose later.[11]

B. Enforceability of Arbitration Agreements

Mississippi's Construction Arbitration Act is drawn in favor of enforcement of arbitration agreements. A reading of the Act makes clear that a court should grant an application for enforcement on the sole basis of the answer to the inquiry: was an agreement to arbitrate made by the parties?[12] If the answer is affirmative, the court is specifically prohibited from reaching the merits of the dispute.[13] If there is a ques-

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[9] *Id.* § 11-15-101(2).

[10] *Id.* § 11-15-101(3).

[11] The general arbitration statute, MISS. CODE ANN. §§ 11-15-1 to -37 (1972), limited enforcement to agreements to arbitrate *existing* disputes. *Id.* § 11-15-1.

The Construction Arbitration Act has changed this rule for those disputes within the scope of the Act. *See supra* note 2. The Act specifically exempts agreements it covers from operation of the general arbitration statutes. MISS. CODE ANN. § 11-15-143 (Supp. 1982).

[12] MISS. CODE ANN. § 11-15-105(1) (Supp. 1982) provides: "If the court finds that no substantial issue exists as to the making of the agreement or provision, it shall grant the application . . ." for an order directing the parties to proceed with arbitration. The court may stay "[a]ny action or proceeding involving an issue subject to arbitration . . . ." *Id.* § 11-15-105(2).

The Construction Arbitration Act is similar in many respects to the Tennessee Cotton Arbitration Act, TENN. CODE ANN. §§ 29-5-201 to -221 (1980). The provisions relating to enforceability are especially relevant. *Compare* TENN. CODE ANN. § 29-5-203 (1980) *with* MISS. CODE ANN. § 11-15-105 (Supp. 1982)(similar provisions as to granting application for order to compel arbitration, stay arbitration, and stay related litigation). Given the similarity of the Mississippi and Tennessee acts, judicial interpretation of the Tennessee provision could be a useful source for possible interpretations of the Mississippi act.

[13] MISS. CODE ANN. § 11-15-105(4) (Supp. 1982). This important section states: "An order for arbitration shall not be refused on the ground that the claim in issue lacks merit or bona fides or because any fault or grounds for the claim sought to be arbitrated

tion whether the parties entered the agreement to arbitrate, the court must summarily hear and determine that issue and then either grant or deny an order for arbitration.[14] Any other proceeding involving an issue subject to an order for arbitration is stayed unless the issue to be arbitrated is severable, in which case the stay will be ordered only with respect to the issue to be arbitrated.[15] In contrast to the narrow inquiry allowed by the language of Mississippi's Act,[16] most other arbitration statutes use language allowing the court to inquire into areas other than the simple making of the agreement; for example whether grounds exist for revocation of the agreement.[17]

C. *Initiating the Arbitration Proceeding*

The contract of the parties controls most procedural aspects of the arbitration proceeding.[18] This is beneficial because it allows the parties

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have not been shown." *Id.* Thus, the court, in ruling on an application or motion for an order compelling arbitration, may not look to the merits of the controversy, or apparently even determine whether the controversy falls within the arbitration agreement.

[14] *Id.* § 11-15-105(1). This section embodies a legislative directive which, if followed, will enhance the enforceability of arbitration agreements under the Act. The section states in part: "If the court finds that no substantial issue exists as to the making of the agreement or provision [to arbitrate], it shall grant the application." *Id.*

[15] *Id.* § 11-15-105(2). This section provides for an automatic stay of all other legal proceedings involving the issue subject to arbitration. *Id.*

[16] *See supra* notes 13-14 and accompanying text. Summary disposition by the court would defeat attempted delay of arbitration at this stage. At the same time, a party to a contract containing an arbitration provision could use the stay provision of § 11-15-105 to delay *litigation* of the other party's claim by asserting the arbitration agreement as an affirmative defense. The right to assert the arbitration agreement as a defense is waived, however, unless the defendant raises it before or in his answer to the complaint. MISS. CODE ANN. § 11-15-103 (Supp. 1982). Thus, the answering party can halt the legal proceedings and have his claim, no matter how frivolous or meritless, taken through a full-scale arbitration proceeding.

[17] *E.g.*, CAL. CIV. PROC. CODE § 1281.2 (West 1982) (agreement enforceable unless right waived or "grounds exist for the revocation of the agreement"); N.Y. CIV. PRAC. LAW § 7503(a) (McKinney 1980) ("where there is no substantial question whether a valid agreement was made or complied with, and the claim sought to be arbitrated is not barred by [the statute of limitations] the court shall direct the parties to arbitrate."); TENN. CODE ANN. § 29-5-202 (1981) (agreement enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract.").

[18] *See* MISS. CODE ANN. § 11-15-107 (Supp. 1982) (if agreement provides a method for initiation of arbitration proceeding, it will be followed); *id.* § 11-15-109 (if agreement establishes a mechanism for appointing arbitrators, it will be followed); *id.* § 11-15-113 (agreement can control time, place, notice, and procedure for the hearing); *id.* § 11-15-117(3) (discovery limitations set out in statute may be exceeded by agreement of the parties); *id.* § 11-15-119(3) (time for making award may be fixed or extended by the

to set the parameters of their exposure to arbitration and tailor the proceedings to fit the circumstances surrounding their contract. If, however, the parties fail to provide specific procedures or to agree on a method of arbitration, the statute fills in the gaps so that the effect of their agreement will not be lost.

Under the Act, the party desiring to initiate arbitration must file with the other party a notice of his intent to utilize the arbitration agreement or provision. This notice must contain a statement of the dispute, the amount involved, and the remedy sought.[19] The party upon whom the demand is made may answer within twenty days; failure to answer will be considered a denial of the claim and will not operate to delay the proceedings.[20] These statutory procedures may be altered by the parties.[21] The initiation of arbitration is a simple process. From a practical standpoint, this initial step may be all that is necessary to bring the other party to the negotiation table and reach a reasonable resolution of the dispute.

D. Selection of the Arbitrators

Subject to certain restrictions discussed below,[22] the parties may agree to any procedure for selecting arbitrators. One of two methods is

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parties); *id.* § 11-15-121 (payment of fees and expenses may be provided for in the agreement); *id.* § 11-15-127 (notice of initial application for order served in manner provided by law for service of summons unless parties agree otherwise); *id.* § 11-15-131 (venue of arbitration applications: county where agreement provides that the hearing will be held; if parties made no provision for location, then county where adverse party resides or has a place of business or, if no residence or place of business, then in any county; if hearing has been held, venue is proper in the county where held).

[19] *Id.* § 11-15-107. Because of the informal nature of arbitration, formal pleading requirements are not necessary. When the agreement fails to specify a procedure for initiating arbitration, the Act requires only that the notice to the other party of an intention to arbitrate contain "a statement setting forth the nature of the dispute, the amount involved, and the remedy sought." *Id.*

[20] *Id.* This provision assures that arbitration will not be hampered by the failure of the other party to respond to the notice invoking the arbitration proceeding.

[21] *See supra* note 18. Parties commonly agree to adopt the procedures of the Construction Industry Arbitration Rules of the American Arbitration Association. These rules set forth a complete and equitable method for arbitration, and are incorporated in the American Institute of Architects (AIA) standard form contracts for the construction industry. *See* Standard Form Contract of the American Institute of Architects (Form A201), General Conditions, Article 7.9. AIA form contracts are widely used, hence the AAA's Construction Arbitration Rules are frequently encountered in construction arbitration. These rules may be obtained from the American Arbitration Association, 1115 Praetorian Bldg., 1607 Main St., Dallas, TX, 75201.

[22] *See infra* notes 26-31 and accompanying text.

commonly used. In an arbitration administered by the American Arbitration Association (AAA), the Association submits identical lists of arbitrators to both parties, who then strike names and rank the remaining names in order of preference. The AAA then selects an arbitrator or a panel from the revised lists.[23] In the other method, used only with three-member panels, each party selects one arbitrator, and these two arbitrators select the third.[24]

If the method agreed to by the parties should fail or otherwise prove unsuitable, or if the parties omitted a provision for the selection of arbitrators in their agreement, then either party may apply to the court to appoint one or more arbitrators.[25] Although the Act itself does not set any limitations on the selection of arbitrators, the finality of the decision reached in arbitration presumably would make disqualification appropriate in some circumstances. The Act does provide that evident partiality by an arbitrator appointed as a neutral can be a ground for vacating the award.[26] The inference is that anyone, regardless of bias, may be appointed if their bias is known and the other party agrees to it. Past and present relationships such as business, professional, or social ties should be disclosed to avoid bias or the appearance thereof.[27]

For example, in *Commonwealth Coatings Corp. v. Continental*

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[23] CONSTRUCTION INDUSTRY ARBITRATION RULES, *supra* note 21.

[24] Fabyanske & Halverson, *Arbitration: Is it an Acceptable Method of Resolving Construction Contract Disputes?*, 16 FORUM 281, 291 (1980). The second method is not as impartial as the first. *Id. See also* Currie, *Arbitration—the Pros and Cons*, in CONSTRUCTION ARBITRATION: SELECTED READINGS 37, 39-41 (1981) (process of exchanging lists to select arbitrators can result in significant delays; technical expertise of arbitrators should be carefully considered).

[25] MISS. CODE ANN. § 11-15-109 (Supp. 1982). This section also provides for appointment by the court upon application if an arbitrator fails or is unable to act and a successor has not been appointed. *Id.*

[26] *Id.* § 11-15-133(b). The AAA Construction Industry Arbitration Rules, *supra* note 21, § 12, provide that any arbitrator except one appointed directly by the parties under § 14 of the rules shall be neutral and is subject to disqualification under § 19 of the rules. Arbitrators appointed as neutrals are required by § 19 to disclose any circumstances likely to affect their impartiality. Under the AAA rules, the association determines whether disqualification of an arbitrator is needed. *Id.* § 19.

[27] *See* Sanko S.S. Co. v. Cook Indus., Inc., 495 F.2d 1260, 1262-63 (2d Cir. 1973); Richco Structures v. Parkside Village, Inc., 82 Wis. 2d 547, 263 N.W.2d 204, 210-13 (1978); *see also* Note, 11 SETON HALL L. REV., 163, 163-64 (1980) (discussion of effect of undisclosed bias). Impartiality is especially important because of the limited review of an arbitrator's award. The arbitrator(s) should not only be unbiased, but avoid even the appearance of bias. Richter & Kozek, *Construction Arbitration Procedures*, CONSTR. BRIEFINGS, Oct. 1978, at 1, 4.

Casualty Co.[28] the Supreme Court vacated an arbitration award pursuant to section 10 of the United States Arbitration Act,[29] when an arbitrator appointed as a neutral had engaged in business dealings with one of the parties within the previous five years. The Court noted that the only impropriety involved was the failure to disclose the fact of this relationship prior to the arbitration hearing.[30] The Court made it clear that the only requirement is that of disclosure of the prior relationship, based on the overriding principle that both courts and arbitrators should not only be unbiased, but appear to be unbiased also.[31]

One of the most attractive features of arbitration is that the panel that will hear the dispute may be composed of experts in the subject matter of the controversy.[32] This avoids the time-consuming and often expensive process of educating judge and jury in the technical aspects of the case. In construction arbitration, the ideal three-person panel would be composed of two qualified professionals from the construction industry and an attorney familiar with construction law.[33] The Act

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[28] 393 U.S. 145 (1968).

[29] 9 U.S.C. § 10 (1976). This section provides the same general grounds for vacating an award found in most arbitration statutes, namely: 1) award procured by corruption, fraud or undue means; 2) evident partiality or corruption by arbitrators or any of them; 3) arbitrator misconduct in refusing to postpone a hearing where sufficient cause is shown or refusing to hear pertinent and material evidence; 4) arbitrators exceeded their power.

[30] 393 U.S. at 147. The Court stated:

> These provisions [§ 10] show a desire of Congress to provide not merely for *any* arbitration but for an impartial one. It is true that petitioner does not charge before us that the third arbitrator was actually guilty of fraud or bias in deciding this case, and we have no reason, apart from the undisclosed business relationship, to suspect him of improper motives.

Id. (emphasis in original).

[31] 393 U.S. at 749-50. The facts of *Commonwealth Coatings* made it clear that no bias was present, since the decision of the panel was unanimous, and the complaining subcontractor stated that he would not have objected to the third arbitrator had the disclosure been made. 393 U.S. at 152-53 (Fortas, J., dissenting).

[32] *See* Cushman, Ficken & Dodd, *Problems of Arbitration—Litigation,* in CONSTRUCTION LITIGATION 485, 536 (1981) (advantage to have case decided by people who understand case and will make fair decision after hearing all the evidence); Currie *supra* note 24, at 38-41 (valuable discussion of the various forums available and the benefit of having experts hear the dispute).

[33] Currie, *supra* note 24, at 40.

> The ideal three-person panel for most construction disputes probably includes a contractor, an architect or engineer, and a lawyer well versed in construction law. In such a case the persons making the final determination would be able to draw on technical knowledge, experience, and familiarity with industry customs in making their decisions.

Id. For a general discussion of factors to be considered in selecting arbitrators, see Law-

does not specify an appropriate size for arbitration panels, and the parties may choose to use a single arbitrator, especially if the amount in dispute is small. With only one arbitrator, however, the risk is greater that a party will fail to establish rapport conducive to persuasion. This possibility is diminished when a panel of three arbitrators is used.[34]

E. The Arbitration Hearing

The hearing may be set either by agreement of the parties or by the arbitrators, who must then notify the parties at least twenty days before the date set. The notice must be given by personal service or registered mail.[35] If a party appears at the hearing, the right to service is waived.[36] The hearing may be adjourned upon the motion of the arbitrators or a party for good cause shown.[37]

Arbitration is a private and informal forum, and the rules that control courtroom proceedings are optional in the arbitration context. Evidence may be admitted freely within the discretion of the arbitrators. The hearing generally will proceed with a plain statement of the claim and proof offered, with the arbitrators asking questions at various times within the proceeding.[38]

The most important factors are the clarity and persuasiveness of the claim being presented. A good procedure is to start with a brief description of the controversy followed by a discussion of the remedy sought, showing that the arbitrator has the power to grant such a remedy under the agreement. Witnesses and documentary evidence should then be introduced in an orderly manner to facilitate understanding by the arbitrators. The closing should summarize the facts presented and the arguments made, as well as refute important points made by the

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son, *Arbitrator Acceptability: Factors Affecting Selection*, ARB. J., Dec. 1981, at 22-29.

[34] *See* Cushman, Ficken & Dodd, *supra* note 32, at 515-17 (goal of selecting arbitrators is like jury selection; disadvantages of using single arbitrator are a party's risk of not developing persuasive rapport and the loss of benefit from having combined expertise of architect, engineer, contractor).

[35] MISS. CODE ANN. § 11-15-113 (Supp. 1982).

[36] *Id.*

[37] *Id.* The arbitrators "may" adjourn the hearing on their own motion and "shall" do so upon the request of any party "for good cause shown." *Id.*

[38] *See* Cushman, Ficken & Dodd, *supra* note 32, at 517-23 (giving example of typical case and contrasting the presentation to an arbitration panel with the presentation to a jury); Currie, *supra* note 24, at 40-42 (arbitrators usually liberal in receiving evidence, particularly since refusal to hear evidence after proper objection may be grounds for vacating award). Since technical rules of evidence are not usually followed, presentation of documentary material and testimony is easier and faster, but arbitrators may choose to disregard the evidence admitted. *Id.* at 41.

other party.[39] The organization of the presentation inevitably will affect the impression made on the arbitrators. Any lack of organization will prevent the communication of important points to the arbitrators. Preparation for arbitration is just as important and should be just as thorough as that done for a trial, so the arguments made will flow logically and consistently from point to point.[40]

F. The Award

The scope of remedies available to arbitrators is not restricted to forms of relief courts might grant. Any remedy or relief that is just and equitable is appropriate, provided that it is within the scope of the agreement of the parties.[41] If the hearing is before a panel of arbitrators, the majority decides the case unless the agreement provides otherwise.[42] The Construction Arbitration Act provides that an award must be made in writing, and a copy must be delivered to each party either personally or by registered mail, unless otherwise agreed.[43] If the agreement does not specify a time for the making of the award, then either party may apply to the court to have a time designated. The right to object to delay in the making of the award, however, must be preserved by giving notice to the arbitrators of the objection before the award is delivered.[44]

G. Discovery in the Arbitration Proceeding

Mississippi is fortunate that the legislature explicitly provided for pre-hearing discovery in the Construction Arbitration Act. Under the Act, the extent of allowed discovery is simply a matter of agreement by

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[39] Coulson, *Arbitration in the Eighties: How to Make it Work for You*, 16 FORUM 673, 677 (1981). This article contains very practical suggestions about preparing for an arbitration hearing. The preparation for arbitration in essence is similar to that done for a trial, however, the techniques used will necessarily be different. Direct examination of witnesses and introduction of documentary evidence are emphasized. *Id.* at 677-78.

[40] *See generally* Currie, *supra* note 24, at 54 (logical sequence of presentation of witnesses [and hence the case] is usually chronological); Richter & Kozek, *supra* note 27, at 8 (orderly step-by-step presentation of how, why and in what amount damages were incurred is best).

For an exceptional treatment of the methods for proving liability and damages, using such means as charts, summaries, demonstrative evidence, photographs, expert testimony and computer-compiled evidence, see Currie, *supra* note 24, at 55-59.

[41] MISS. CODE ANN. § 11-15-119 (Supp. 1982).

[42] *Id.* § 11-15-111.

[43] *Id.* § 11-15-119(2).

[44] *Id.* § 11-15-119(3).

the parties or discretion of the arbitrators.[45] The Act also provides that the arbitrators may issue subpoenas for witnesses and for the production of documents, records, books and other evidence, as well as allow the deposition of any person upon application of a party.[46] It is hoped that this statutory scheme will prevent some of the problems that arise when an arbitrator denies requested discovery or one party to the arbitration refuses to comply with a discovery request.

Obviously, when it is necessary to litigate the question of how much discovery should be allowed in an arbitration proceeding much of the speed, privacy, and efficiency of the proceeding is lost.[47] This particularly is so because most courts have been reluctant to order discovery in aid of arbitration, and consequently have required a showing of strict necessity before granting such discovery.[48] This standard seems to be softening to some degree,[49] but a statutory grant of power to the arbitrator(s) to decide discovery disputes within limits is certainly a system that will prove better suited to the needs of the arbitration process. Independence from court interference will allow arbitration to retain those characteristics that distinguish it from and make it preferable to the courts as a means of resolution for certain disputes.[50]

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[45] *See id.* § 11-15-117. The parties to an arbitration agreement may, of course, agree to any volume or method of discovery they desire. *Id.*

[46] *Id.* Most state arbitration statutes are silent as to the extent of discovery which is allowed. Fabyanske & Halverson, *supra* note 24, at 291. *See also* Currie, *supra* note 24, at 41-44 (generally no discovery in arbitration unless specified in statute, and most statutes are silent on the subject).

[47] *See* M. CALLAHAN & B. BRAMBLE, DISCOVERY IN CONSTRUCTION LITIGATION, 141-43 (1983).

[48] *See, e.g.*, Burton v. Bush, 614 F.2d 389, 390-91 (4th Cir. 1980); Levin v. Ripple Twist Mills, Inc., 416 F. Supp. 876, 880 (E.D. Pa. 1976); Balfour, Guthrie & Co. v. Commercial Metals Co., 93 Wash. 2d 199, 607 P.2d 856, 858 (1980).

[49] *See, e.g.*, Bigge Crane & Rigging Co. v. Docutel Corp., 371 F. Supp. 240, 246 (E.D. N.Y. 1973). *See generally Relaxing the Standard For Court-Ordered Discovery In Aid of Commercial Arbitration*, 50 FORDHAM L. REV. 1448 (1982).

In *Bigge Crane* the court stated: "Arbitration is not a separate proceeding independent of the courts, as was sometimes thought. The courts are brigaded with the arbitral tribunal in proceedings to compel arbitration or stay judicial trials, proceedings to enforce or quash subpoenas issued by arbitrators. . . ." 371 F. Supp. at 246. The court allowed the discovery, considering its necessity, the large amount in controversy, the fact that discovery still could be taken without significant delay, and that only one of five defendants moved to stay the trial. *Id.* The court did not discuss the issue whether the scope of discovery should be left within the discretion of the arbitrator.

[50] *Cf.* M. CALLAHAN & B. BRAMBLE, *supra* note 47, at 143, 162 (discovery limited in arbitration for good reason; arbitrators are best able to decide what discovery is necessary while preserving the integrity of the proceeding). *See generally* Willenken, *The Often Overlooked Use of Discovery in Aid of Arbitration and the Spread of the New*

Since litigation over discovery in aid of arbitration is always a possibility, the amount of discovery needed to prove a claim should be a consideration when deciding whether to arbitrate or use the court system. Because the Mississippi Act does mention discovery in terms of a grant of discretion to the arbitrators, it appears that a court would be clearly justified in relying on the arbitrators' determination of the amount of discovery needed to resolve the dispute.[51] In this respect, the Act may be construed in a manner that would prevent delay incident to appeals to the court for orders compelling discovery or protecting a party from discovery. If the Act is interpreted as, absent agreement of the parties, vesting sole discretion for determination of the scope of allowed discovery in the arbitrators, the only need for resort to the court would be for enforcement of subpoenas or other discovery orders of the arbitrators.[52]

H. Third Parties in the Arbitration Proceeding

When a conflict arises in the construction context, it rarely involves only two parties.[53] Though the dispute may be primarily between two of the contracting parties, others performing certain functions in the project often will be involved or affected by the outcome. Mississippi's Construction Arbitration Act is silent concerning joinder of other parties and consolidation of arbitration proceedings arising from the same dispute or from substantially related facts.

In a simplified example of a construction project, an owner will contract with an architect for the design and supervision of the construction of a building. On the basis of plans that the architect produces, bids will be taken and a contract will be signed with the contractor being chosen by the owner and architect. On any large project, the owner will require that the prime contractor provide performance and payment bonds. The payment bond protects the owner from laborers' and materialmen's liens on the building that could result if the

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York Rule to Federal Common Law, in CONSTRUCTION ARBITRATION: SELECTED READINGS 63 (1981) (complete discussion of the various views on discovery in aid of arbitration taken by the courts).

[51] Absent extreme facts, the court should defer to the decision of the arbitrator as to the scope of discovery; this accords with a reading of the language of MISS. CODE ANN. § 11-15-117 (Supp. 1982): the arbitrators "*may* issue subpoenas" and "*may* permit a deposition to be taken." *Id.* (emphasis added).

[52] *See id.* § 11-15-117(1) (court will enforce subpoenas issued by arbitrators).

[53] *See* Currie, *supra* note 24, at 47-49 (multi-party arbitration apparently provides most expeditious dispute resolution in construction cases that are complex and rarely involve only two parties, but few contracts provide for it).

prime contractor fails to pay for work or supplies furnished by others for the project. The performance bond guarantees the faithful performance of the contractor. The prime contractor usually subcontracts certain parts of the work and often will require or be required to assure that the subcontractors also provide a bond. Both the prime contractor and the subcontractor will contract with suppliers for materials necessary for the project. Because of the dependence of each of these parties on performance by others, breach of one of these contracts is likely to affect several parties.[54] Of these related contracts, some may contain arbitration provisions while others do not. Hence, it often is necessary to determine whether an arbitration agreement is enforceable not only against the party who agreed to arbitrate, but also against other parties with whom there is no explicit agreement, but who nonetheless are ultimately liable.

The general rule is that an agreement to arbitrate is binding only on the parties who signed it;[55] arbitration does not have the equivalent of third party practice. This is consistent with the idea of arbitration as a consensual forum. Yet, there are circumstances in which the parties to a dispute may want a third party to participate in the arbitration proceeding.[56] In other situations, third parties may want to par-

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[54] For example, if a subcontractor causes delays in the performance of the contract, the contractor may be liable for liquidated damages to the owner. *See* L. OTT AND D. MOCKBEE, MISSISSIPPI CONSTRUCTION LAW, 228-29 (1981). Tardy performance of one subcontractor may delay the performance of others. It may be that the prime contractor has a claim against the owner or architect for negligent preparation of plans and specifications or interference with performance of the contract. *See, e.g.,* Owen v. Dodd, 431 F. Supp. 1239, 1242 (N.D. Miss. 1977). The surety may assert claims for money negligently paid in violation of the payment provisions of the owner-contractor agreement. *See* State v. Malvaney, 221 Miss. 190, 207-11, 72 So. 2d 424, 430-32 (1954).

[55] Cushman, Ficken & Dodd, *supra* note 32, at 502. "Arbitration is a creature of contract. Because of its nature, there generally are only two parties to the agreement to arbitrate. Can a dispute involving various parties, but having similar factual issues, be consolidated into one proceeding when the parties are not in contractual privity with one another?" *Id.*

The joinder of parties and consolidation of arbitration proceedings usually results in a more equitable resolution, free from the danger of inconsistent decisions and wasted efforts, but it complicates arbitration, delays resolution and distorts the purpose of arbitration as an efficient and expeditious forum. Richter & Kozek, *supra* note 27, at 6.

[56] A common example is when the contractor institutes a claim against the owner, and the design is in question. If consolidation is available, the owner may demand arbitration with the architect and move to consolidate the two proceedings. At that point, the owner can stand by and watch the contractor and architect attempt to prove each other liable for the claim. If the architect can escape consolidation, he is in a good position to argue that all of the problems were caused by the contractor without the contractor present to dispute his theory. Fabyanske & Halverson, *supra* note 24, at 285.

ticipate in the arbitration because they may be bound or otherwise affected by the result.[57]

The question whether a third party may be brought into an arbitration proceeding often arises in the context of the surety. Although the surety's bond incorporates the contract between the owner and the contractor (or contractor and subcontractor) by reference, this has been held not to constitute a consent to arbitration.[58] The surety may be bound by the arbitration clause in the principal's contract if it undertakes the performance or completion of the contract,[59] becomes a party to the contract,[60] takes an assignment of a contract with an arbitration clause in it,[61] or succeeds to the rights and obligations in a contract by subrogation.[62] There is authority both for holding the surety to its principal's arbitration agreement by virtue of the bond's incorporation of the contract and for requiring something more before compelling a surety to arbitrate.[63] In any case, the surety upon which demand for arbitration is made should make a motion to stay the arbitration,

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[57] *See* Ruck, *Can a Contract Bond Surety Be Compelled to Arbitrate Claims Against It?*, 16 FORUM 765, 772-73 (1981) (because of financial condition of contractor, surety might wish to join arbitration proceeding when it feels the claim will not be properly defended by the principal).

[58] *Id.* at 769-72.

[59] MSP Collaborative Developers v. Fidelity & Deposit Co. of Maryland, 596 F.2d 247, 250-52 (7th Cir. 1979). In *MSP* the surety arranged for the completion of the principal's work after default by the principal. Subsequently, the owner sued in state court to compel the surety to arbitrate the owner's claim for damages caused by the contractor's breach. The surety removed the case, and the court denied the surety's motion to strike the application for arbitration. *Id.* at 248-49.

[60] *See* Louis Michel, Inc. v. Whitecourt Constr. Co., 264 N.Y. 260, 189 N.E. 767 (1934).

[61] *See* Fisser v. International Bank, 282 F.2d 231, 233 n.6 (2nd Cir. 1960) (corporation's acts bound it to arbitrate despite the fact that it had not actually signed agreement); *In re* S & L Vending Corp. v. 52 Thompkins Ave. Restaurant, Inc., 26 A.D.2d 935, 274 N.Y.S.2d 697, 698 (1966).

[62] *See* Wells Fargo Bank Int'l Corp. v. London S.S. Owners' Mut. Ins. Ass'n, 408 F. Supp. 626, 629-30 (S.D.N.Y. 1976); Lumbermens Mut. Casualty Co. v. Borden Co., 268 F. Supp. 303, 313 (S.D.N.Y. 1967); Psaty & Fuhrman, Inc. v. Continental Casualty Co., 278 A.D. 159, 103 N.Y.S.2d 849, 852 (1951).

[63] *Compare* Windowmaster Corp. v. B. G. Danis Corp., 511 F. Supp. 157, 161 (S.D. Ohio 1981) (surety not bound by arbitration agreement although bond incorporated principal's entire contract) *and* TransAmerica Ins. Co. v. Yonkers Contracting Co., 267 N.Y.S.2d 669, 671 (1966) (same) *with* Kearsarge Metallurgical Corp. v. Peerless Ins. Co., 418 N.E.2d 580, 583 (Mass. 1981) (surety bound by arbitration agreement because bond incorporated principal's contract) *and* Powers Regulator Co. v. United States Fidelity & Guar. Co., 7 Mass. App. 913, 388 N.E.2d 1205, 1207 (1979) (same).

thereby framing the issue for the court to decide.[64]

An attempt to bring unwilling third parties into an arbitration proceeding will be met with the defense that they did not agree to arbitrate except as specified in their contract. Multi-party arbitration agreements in which the parties consent to consolidated arbitration may be used to avoid the problems related to the joinder of other parties and should be enforced by the courts.[65] When consolidation has been attempted without a multi-party agreement under state arbitration laws, some cases allow consolidation even over the objections of one of the parties.[66] Courts interpreting the Federal Arbitration Act in similar situations have ordered consolidation.[67] Courts that refuse to order consolidation usually base their decisions on the fact that separate contracts are involved, lack of privity, or distinct differences in the subject matter of the dispute.[68]

Even in the absence of consolidation, the result of the arbitration likely will be visited on the party ultimately liable in the contractual chain.[69] If an arbitration proceeding involves issues that determine liability that may pass to one not a party to the arbitration, even though the issue of liability will be retried, the initial award tends to remain intact.[70]

I. The Award: Limited Review

After the arbitrators have rendered their decision, a party may request the arbitrators to modify or correct the award. This application

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[64] *See* MISS. CODE ANN. § 11-15-105 (Supp. 1982).

[65] Fabyanske & Halverson, *supra* note 24, at 284.

[66] *E.g.*, Grover-Dimond Assoc. v. American Arbitration Ass'n, 297 Minn. 324, 211 N.W.2d 787, 788 (1973) (owner sought joint arbitration against contractor and architect, contractor agreed but architect objected; court ordered a consolidated hearing, referring to policy of encouraging arbitration and provision for joinder and consolidation in the state's rules of civil procedure).

[67] *See, e.g.*, Robinson v. Warner, 370 F. Supp. 828, 829-31 (D.R.I. 1974).

[68] *See* Fabyanske & Halverson, *supra* note 24, at 285.

[69] *See id.* at 283-84.

[70] *Id.* In addition to the retrial or rearbitration, if a contract includes an indemnity clause, the party which was primarily liable may be able to recover under contractual or implied indemnity. *See* Celotex Corp. v. Becknell Constr., Inc., 325 So. 2d 566, 567-69 (Miss. 1976)(material supplier and roofing subcontractor liable for indemnity to prime who paid judgement for a defective roof); *cf.* Home Ins. Co. v. Atlas Tank Mfg. Co., 230 So. 2d 549, 551 (Miss. 1970) (party only passively negligent if held liable may recover from party who was actively negligent); Bush v. City of Laurel, 215 So. 2d 256, 259-60 (Miss. 1968) (same).

must be made within twenty days of the receipt of the award.[71] The party may also make the same application to the circuit court within ninety days of the receipt of the award.[72] The grounds for both applications are: an evident miscalculation of figures or mistake in the description of any person, thing or property referred to in the award; an award made on a matter not submitted if it may be corrected without disturbing the matters decided that are within the scope of the submission; and an imperfection of form not affecting the merits of the award.[73]

One of the most difficult accomplishments in the field of arbitration is that of having an award vacated.[74] The Mississippi Act provides the same general grounds for vacating an award as most arbitration statutes.[75] Specifically, the Act provides that an award will be vacated when "the award was procured by corruption, fraud or other undue means," and for "evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party."[76] To have an award vacated, the dissatisfied party must apply to the circuit court within ninety days of receipt of the award unless the basis is corruption, fraud or other undue means; in those cases the application must be made within ninety days after the grounds are or should be known.[77] A motion to vacate an

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[71] MISS. CODE ANN. § 11-15-123 (Supp. 1982).

[72] *Id.* § 11-15-135.

[73] *Id.* § 11-15-123, -135 (§ 123 makes the standard of § 135 applicable).

[74] An arbitral award is traditionally overturned only on very narrow grounds, in situations in which there is evidence of fraud, corruption, or gross negligence. Even if the award was based on errors of fact or law, it will usually be upheld. This is reinforced because arbitrators do not have to set out the reasons for their award, so no findings of fact are available on which to predicate an appeal. This stands in contrast to the elaborate appellate system of the courts. Currie, *supra* note 24, at 43.

"There are few things more difficult in appellate practice than successfully appealing a final decision of an arbitration panel. The cornerstone to the underlying arbitration agreement is the parties' acceptance of the final decision of the arbitrators as binding." Fabyanske & Halverson, *supra* note 24, at 292.

The courts will rarely set aside an award on the basis that it is erroneous as a matter of law, unless there is a complete disregard of the law by the arbitrators. *See* Fukaya Trading Co. v. Eastern Marine Corp., 322 F. Supp. 278, 282-83 (E.D. La. 1971).

[75] *See* UNIFORM ARBITRATION ACT § 21 (1955). Grounds for vacating an award listed in this section include: 1) procurement by corruption, fraud or any undue means; 2) partiality on the part of an arbitrator appointed as a neutral; 3) misconduct or corruption of the arbitrator; 4) exceeding the power of the arbitrator; 5) refusal of arbitrator to hear material evidence or to give a postponement where there was sufficient cause; 6) prejudicial misconduct of the hearing; and 7) lack of a valid arbitration agreement.

[76] MISS. CODE ANN. § 11-15-133 (Supp. 1982).

[77] *Id.* § 11-15-133(2).

award may be joined with a motion to modify or correct.[78]

II. Enforcement and Avoidance: Litigation

The Mississippi Act sets up methods by which a party may compel arbitration pursuant to an agreement or have an arbitration proceeding stayed if no agreement to arbitrate exists.[79]

To enforce an agreement to arbitrate or have arbitration proceedings stayed, a party should apply to the circuit court of the county where the arbitration proceeding was or is to be held, or, if the location of the hearing has not been determined, the county where the opposing party resides or has a place of business.[80] If the adverse party neither resides nor has a place of business in the state, and the location for the hearing is undetermined, then venue is proper in the circuit court of any county.[81] The Act states that, unless otherwise provided, applications to the circuit court are to be by motion, with the notice required by law or rule of court for the making and hearing of motions.[82] A party may attempt to defeat an arbitration demand in circuit court through motions to deny arbitration because no agreement exists or the claim is outside the scope of the agreement, or by asserting defenses such as undue delay or waiver.

If one party initiates litigation concerning the contract in dispute, then the other party will be deemed to have waived the arbitration provision if it is not asserted as a defense on or before an answer is due in the suit. The Act expressly provides that this waiver is a defense to an arbitration demand.[83] The Act also allows the parties to include a contractual statute of limitations in the arbitration agreement, and this agreement will be given effect and may be asserted as a defense to a demand for arbitration.[84] Undue delay in asserting a claim may be a

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[78] *Id.* § 11-15-135(3).

[79] *Id.* § 11-15-105. Often the benefits of arbitration are diminished when a party is recalcitrant and the enforcement mechanisms must be used. As noted many years ago:

> There is irony in the fate of one who takes precautions to avoid litigation [by agreeing to submit] to arbitration, and who, as a reward for his pains, finds himself eventually in court fighting not on the merits of his case but on the merits of the arbitration. And when we mass hundreds of thousands of situations in which the courts have passed on arbitrations . . . unless we lose all sense of realism the total result is a monumental tragi-comedy.

Isaacs, Book Review, 40 Yale L.J. 149, 149 (1930).

[80] Miss. Code Ann. § 11-15-129, -131 (Supp. 1982).

[81] *Id.* § 11-15-131.

[82] *Id.* § 11-15-127.

[83] *Id.* § 11-15-103.

[84] *Id.* § 11-15-107.

persuasive defense to a suit to compel arbitration even in the absence of a contractual limitation.[85] In this connection, whether or not the general contract statute of limitations has run may be an important factor.[86] There are, of course, a variety of other motions that may be necessary in the context of the particular arbitration proceeding, for example those dealing with selection of arbitrators, place and time of the arbitration hearing, and (possibly) extent of allowable discovery.[87]

The Act specifically designates those actions of the circuit court that may be appealed; appeals are taken in the same manner as those in an ordinary civil action.[88] The actions designated as appealable are: an order denying an application to compel arbitration; an order granting an application to stay arbitration; orders confirming, denying, modifying or correcting an award; an order vacating an award without directing a rehearing; or a judgment or decree entered pursuant to the provisions of the Act.[89] This last category would include an order entered pursuant to section 11-15-105 compelling arbitration, an order not specifically defined as being appealable.[90]

The Construction Arbitration Act is drawn in favor of enforcing arbitration agreements, and the procedures in court outlined above are designed to aid in this objective by preventing the abuse of arbitration. It would be irrational to ignore the pragmatics of the marketplace, however, and clearly these procedures may be used purely to delay or prevent arbitration altogether.[91] Regardless of how laudable conduct that expedites arbitration may be, to many such ideal conduct "is the

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[85] *See* Annot., 25 A.L.R. 3d 1171 (1969) (delay in asserting contractual right to arbitration as precluding enforcement). *See also* Brenner, *Arbitration: Compulsion and Avoidance*, 17 FORUM 656, 656 (1982) (not abuse of discretion for district court to rule on defense of laches as a motion decided on pleadings instead of after hearing—discussing Federal Arbitration Act).

[86] *See* Annot., *supra* note 85, at 1184-85.

[87] *See supra* notes 22-27, 35-37, 45-52 and accompanying text.

[88] MISS. CODE ANN. § 11-15-141 (Supp. 1982).

[89] *Id.*

[90] *See id.* § 11-15-105(1).

[91] With many claims, it is often in the best interest of the defendant to delay having to pay as long as possible. The traditional defendant has all the usual dilatory motivations, and "[i]f there is ever to be a day of reckoning, he would like it delayed as long as possible." Brenner, *supra* note 85, at 656.

Some typical routes taken by a party seeking to avoid arbitration are alleging that the particular dispute is beyond the scope of the arbitration agreement, denying the existence of an arbitration agreement, claiming that the agreement was fraudulently induced, or complicating the controversy by adding multiple parties and the risk of inconsistent results if separate proceedings are instituted. Fabyanske & Halverson, *supra* note 24, at 89-90.

world of the Haydn minuet performed in a baroque ballroom by elegantly attired gentry. This is not the kind of party to which we get invited very often. [We usually] must deal with a more mundane and shabby world . . . where self-interest and economic forces dominate the parties' behavior."[92]

III. Effect of the Mississippi Construction Arbitration Act

The primary effect of the Mississippi Construction Arbitration Act will be realized in relation to local construction projects not cognizable under the Federal Arbitration Act.[93] Cases under the Federal Act are properly brought in state court if no independent ground of federal jurisdiction exists,[94] but in order to come within the purview of the Federal Act at all the contract out of which the dispute arose must involve interstate commerce.[95] Although it is not entirely clear what degree of involvement with interstate commerce is sufficient to confer jurisdiction under the Federal Act,[96] the Mississippi Act will certainly prove valuable in enforcing arbitration agreements in those projects found not to have the requisite connection with interstate commerce.

The use attorneys make of the arbitration process and the courses

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[92] Brenner, *supra* note 85, at 657.

[93] It should be noted that the State Highway Arbitration Board is specifically exempted from the operation of the Construction Arbitration Act. Miss. Code Ann. § 11-15-101(2) (Supp. 1982). The statute creating the Highway Arbitration Board controls the resolution of contract disputes involving less than $25,000 arising out of contracts between the state highway department and contractors. *See* Miss. Code Ann. §§ 65-2-1, -5 (Supp. 1982).

[94] *See* Main v. Merrill, Lynch, Pierce, Fenner & Smith Inc., 67 Cal. App. 3d 19, 24-26, 136 Cal. Rptr. 378, 380-82 (1977); A/S J. Ludwig Mowinckels Rederi v. Dow Chemical Co., 25 N.Y.2d 576, 579-80, 255 N.E.2d 774, 776, 307 N.Y.S.2d 660, 662-63, *cert. denied*, 398 U.S. 939 (1970). The Federal Act does not of itself confer jurisdiction, hence an independent basis of jurisdiction such as diversity of citizenship is required to bring an action under the Act in federal court. *See* Metro Indus. Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 384 (2d Cir.), *cert. denied*, 368 U.S. 817 (1961); S.J. Groves and Sons Co. v. American Arbitration Ass'n, 452 F. Supp. 121, 123 (D. Minn. 1978). Note that when an action under the Federal Act is brought in state court, the state court applies federal law — a so-called "reverse-Erie" situation. *See* Robert Lawrence Co. v. Devonshire Fabrics, 271 F.2d 402, 407 (2d Cir. 1959), *cert. granted*, 362 U.S. 909, *cert. dismissed*, 364 U.S. 801 (1960).

[95] 9 U.S.C. § 1 (1976).

[96] *Compare* Withers-Busby Group v. Surety Indus. Inc., 538 S.W.2d 198, 199 (Tex. Civ. App. 1976) (fact that interstate commerce was contemplated by parties did not bring agreement under Act) *with* R.J. Palmer Constr. Co. v. Wichita Band Instrument Co., 642 P.2d 127, 130 (Kan. App. 1982) (fact that interstate commerce was contemplated by parties did bring agreement under Act).

judges follow in construing the Act in the next few years will determine its practical utility. The Act should be given a broad reading to reduce to a minimum the amount of court intervention required in the arbitration proceeding. The scope of discovery, for example, should be left to the arbitrators and the parties, with the court stepping in only to enforce discovery orders of the arbitrators.[97] When litigation is necessary to enforce arbitration, many of the benefits of arbitration are lost; therefore the Construction Arbitration Act should be interpreted to make the arbitration proceeding as nearly independent of the courts as possible.[98]

Perhaps most important, this Act providing for enhanced enforceability of arbitration agreements in one narrow area is the groundwork for an innovative era in alternative dispute resolution in Mississippi. In many situations, arbitration will result in the best resolution of a claim or dispute. Often a final decision quickly reached will be important, because protracted litgation costs a great deal in terms of legal expenses and the businessman's time.[99] The use of arbitrators knowledgeable in a particular field, especially in technical disputes, is also a factor that may favor the use of arbitration.[100] If the parties utilize an arbitration agreement and fulfill the provisions of the agreement when a dispute arises, the potential for reaching a favorable result is just as great in a private arbitration hearing as it is after a long, contentious ordeal in the court system.[101] Just as important, the decision of an arbitration panel is frequently based more on the practice of the marketplace than legal technicalities, while in the courts it is often difficult to explain to the layman exactly why he won or lost. Even a losing party surely will be more willing to accept a judgment if he understands the reasons behind the judgment.

The passage of this Act will perform a valuable service simply in familiarizing attorneys and businesspeople with the benefits of arbitration as a viable alternative to litigation. The particular aspects of a

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[97] *See supra* notes 45-52 and accompanying text.

[98] *See infra* notes 99-101 and accompanying text.

[99] *See* Hoellering, *supra* note 4, at 2-4 (speed of resolution is especially important to contractors seeking to collect money owed, since time passage can reduce the chances of recovery).

[100] *Id. See* Currie, *supra* note 24, at 40-41 (ideal three-person panel provides needed experience to fairly decide a dispute).

[101] Currie, *supra* note 24, at 41. The benefit of a private hearing is important because "few companies benefit from having their management procedure and financial condition become a matter of public record. This privacy factor also prevents the ultimate outcome of the proceedings from becoming a precedent for future disputes." *Id.*

dispute must, of course, be analyzed in terms of the forums open for its resolution. With the cloud of obscurity surrounding the arbitration process diminished at least to some degree, it should take its place as a realistic alternative forum not just in the construction context, but in all areas amenable to its use.

David Ott

RECENT DECISIONS

Equity Jurisdiction—Punitive Damages—Mississippi Chancery Courts Are Empowered to Award Punitive Damages

Plaintiff[1] instituted a class action in the Chancery Court of Adams County charging defendants[2] with fraud and breach of fiduciary duty arising out of a relationship between plaintiff and defendants as co-tenants and joint venturers with regard to certain oil and gas leases.[3] Plaintiff's bill requested injunctive relief,[4] an accounting, actual and punitive damages, and attorney's fees.[5] Defendants filed general and

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[1] The named plaintiff, S. Barnett Serio, Sr., represented a class which included himself, G.G. Cornwell, and all persons comprising Tideway Oil Limited Partnership 1975-1 and Tideway Oil Limited Partnership 1975-2. Tideway Oil Programs, Inc. v. Serio, 431 So. 2d 454, 455 (Miss. 1983) (majority opinion by Broom, J.). The majority opinion is divided into two parts. Part I, written by Justice Broom, dealt with the question of venue whether Mississippi courts had subject matter jurisdiction. *Id.* at 457-58. Part II, written by Justice Robertson, addressed the issue of whether chancery courts had the power to assess punitive damages. *Id.* at 459 (majority opinion of Robertson, J.). All of the justices concurred in Part I and Justices Broom, Walker and Hawkins dissented as to Part II. *Id.* at 467.

[2] Defendants were Tideway Oil Programs, Inc., Tideway Energy Group, Inc., Miller Oil Purchasing Company, Dave Gammill, and Tideway Energy Limited Partnership 1977-2. *Id.* at 455 (majority opinion by Broom, J.).

[3] *Id.* at 455-57. Tideway Oil Programs, Inc. (TOPS) formed two limited partnerships and was named managing partner of both. *Id.* at 456. TOPS and the Tideway Energy Group acquired several oil, gas, and mineral leases on 480 acres of land in Louisiana. The leases were then assigned to Serio and the two limited partnerships in various ownership percentages. An operating agreement, which named TOPS as unit operator, was circulated for execution among the owners of the interests. Plaintiff signed the operating agreement, which provided that no partnership was being formed and that any liability which might arise would be borne by the parties severally. The plaintiff alleged that this agreement was obtained by defendants fraudulently because defendants had engaged in leasing adjacent productive acreage without plaintiff's knowledge and to his exclusion. *Id.* Defendants were charged with breach of fiduciary duty for their failure to convey proportionate interests in the adjacent property to Serio and the limited partnerships. *Id.* at 456-57.

[4] *Id.* at 455-56. Plaintiff's bill requested that defendants be compelled to execute assignments of proportionate interests in the newly acquired property in favor of plaintiff and the limited partnerships. *Id.*

[5] *Id.* at 456. Both actual damages in the amount of $200,000 and punitive damages

special demurrers, all of which were overruled and denied.[6] On interlocutory appeal[7] the Mississippi Supreme Court, *held*, affirmed and remanded.[8] Mississippi chancery courts have subject matter jurisdiction over requests for punitive damages, which may be awarded in proper cases at the chancellor's discretion, according to the same standards that are applicable in circuit court. *Tideway Oil Programs, Inc. v. Serio*, 431 So. 2d 454 (Miss. 1983).

Punitive damage awards have been defined as amounts that plaintiffs may recover, in addition to compensatory damages, for the purpose of making an example of the defendant.[9] Historically punitive, or exemplary, damages have been assessed in cases involving insult, oppression, or fraud and in which the defendant has conducted himself in a reckless and wanton manner, without regard for the rights of others.[10] American courts have advanced several theories to support

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in the amount of $1,500,000 were sought by plaintiff. *Id.* at 459 (majority opinion by Robertson, J.).

[6] *Id.* at 456 (majority opinion by Broom, J.). Defendant's motion for interlocutory appeal was also overruled. *Id.*

[7] An interlocutory appeal from chancery court can be granted by a supreme court justice, even though such an appeal has been denied by the chancellor. MISS. CODE ANN. § 11-51-7 (Supp. 1982). On appeal, the defendants questioned the Mississippi chancery court's subject matter jurisdiction and also argued that (1) no cause of action was stated by the complaint; (2) plaintiff was attempting to enforce the rights of third parties; and (3) venue in Adams County was improper. 431 So. 2d at 456 (majority opinion of Broom, J.).

[8] 431 So. 2d at 456. The supreme court also held that the Mississippi chancery court had subject matter jurisdiction over the defendants, as the issue in the case did not involve an adjudication of title to Louisiana land, but rather involved a choice of whether to apply Mississippi or Louisiana law. *Id.* at 457. The court then ruled that defendant's motion to transfer the case was overruled in error and ordered the case transferred to the Chancery Court of the First Judicial District of Hinds County. *Id.* at 459.

[9] Neal v. Newburger Co., 154 Miss. 691, 699-700, 123 So. 861, 863 (1929). Punitive damages were not awarded to benefit or compensate the plaintiff for her injuries. One purpose in assessing punitive damages was to deter others from engaging in conduct similar to that engaged in by the particular defendant involved. *Id.*, 123 So. at 863.

[10] West Brothers, Inc. v. Barefield, 239 Miss. 530, 542, 124 So. 2d 474, 480 (1960). *See* Woodall v. Ross, 317 So. 2d 892, 896 (Miss. 1975) (punitive damages recoverable upon proof of fraud); T.G. Blackwell Chevrolet Co. v. Eshee, 261 So. 2d 481, 485 (Miss. 1972) (punitive damages awarded for fraud in forging plaintiff's name on contract of assignment); *see also* SEDGEWICK, A TREATISE ON THE MEASURE OF DAMAGES 87-88 (1912) (punitive damages proper in cases involving fraud or oppression).

Punitive damage awards may also be proper in cases of gross negligence and extreme recklessness. *See* Fowler Butane Gas Co. v. Varner, 244 Miss. 130, 152-53, 141 So. 2d 226, 234-35 (Miss. 1962) (punitive damages not proper absent evidence that defendant intentionally or recklessly backed his truck over a 33-month-old girl).

the practice of awarding exemplary damages.[11] The public justice theory was often used by courts that chose to view the plaintiff as a "private attorney general"[12] bringing a wrongdoing defendant to justice.[13] Most courts have reasoned that punitive damage awards not only punished the particular wrongdoer who was before the court, but also served to deter others from conducting themselves in a similar manner.[14]

In 1854, the Mississippi Supreme Court first upheld an award of punitive damages in *Bell v. Morrison.*[15] The plaintiff brought suit in circuit court on grounds of assault and battery, alleging that the defendants had insulted and beaten him.[16] On appeal by the defendant, the supreme court affirmed an award of punitive damages, reasoning that the trier of fact had the discretion to assess exemplary damages[17] and to determine the amount of such an award[18] after considering all of the

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[11] Belli, *Punitive Damages: Their History, Their Use and Their Worth in Present-Day Society,* 49 U.M.K.C. L. Rev. 1, 5-6 (1980).

[12] *Id.* at 5-6.

[13] *Id.* Punitive damage awards served public justice by providing an incentive for a plaintiff to bring suit when the costs of such a course of action would otherwise be too high. *Id.* at 6. *See* Snowden v. Osborne, 269 So. 2d 858, 860 (Miss. 1972) (exemplary damages rewarded plaintiff for bringing wrongdoer into court); Neal v. Newburger Co., 154 Miss. 691, 700, 123 So. 861, 863 (1929) (same).

[14] Belli, *supra* note 11, at 6. The Mississippi Supreme Court has often cited the "deterrence" theory as support for its policy of awarding exemplary damages. *See, e.g.,* Standard Life Ins. Co. v. Veal, 354 So. 2d 239, 247 (Miss. 1978) (example made of individual defendant and warning issued to others concerning the type conduct involved); Yazoo & M.V.R.R. v. May, 104 Miss. 422, 426, 61 So. 449, 450 (1913) (sanction and deterrence against use of vile curses and insults by a common carrier); Hines v. Imperial Naval Stores Co., 101 Miss. 802, 805-06, 58 So. 650, 651 (1911) (punishment of defendant rather than compensation of plaintiff as basis for assessing exemplary damages).

[15] 27 Miss. 68 (1854).

[16] *Id.* at 81-82. The plaintiff, Morrison, entered a grocery store in which defendant, Bell, and several others were drinking. After Morrison intervened in a violent disagreement between Bell and another man, Bell followed Morrison into the store and savagely assaulted him. Bell and the men with whom he had been drinking then prevented the plaintiff from receiving needed medical attention. *Id.*

[17] *Id.* at 88-89. In Neal v. Newburger Co., 154 Miss. 691, 123 So. 861 (1929), the Mississippi Supreme Court noted that an injured plaintiff has no *right* to an assessment of punitive damages, even though he may have a right to receive compensatory damages. 154 Miss. at 699-700, 123 So. at 863. The trier of fact could, in its discretion, refuse to impose the burden of punitive damages on a defendant, even though an exemplary damage award might have been proper in the particular case at issue. *Id.*, 123 So. at 863.

[18] 27 Miss. at 88-89. *See* Yazoo & M.V.R.R. v. May, 104 Miss. 422, 426, 61 So. 449, 450 (1913) (amount of punitive damages awarded against defendant for vilely cursing and insulting plaintiff is discretionary with jury).

circumstances.[19] Therefore, the amount awarded was not reviewable on appeal unless it was so high as to suggest improper prejudice or conduct by the trier of fact.[20] The *Bell* court's rationale for allowing the assessment of punitive damages was to punish the defendant and to deter others, by way of example, from engaging in similar conduct.[21]

In *Hines v. Imperial Naval Stores Co.*,[22] the supreme court dealt with a request for punitive damages in chancery court.[23] The plaintiff in *Hines* brought suit by way of attachment in chancery court for damages incurred when the defendant boxed several pine trees on the plaintiff's land and removed resin from them without the plaintiff's consent.[24] Despite a finding that the defendant's trespass was willful, the chancellor declined to award punitive damages,[25] and the plaintiff appealed.[26] Following the rules established in *Bell*, the supreme court affirmed the denial of punitive damages[27] and stated that the chancellor had the power, analagous to that of the jury in circuit court, to award exemplary damages.[28] In *Neal v. Newburger Co.*,[29] the supreme

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[19] 27 Miss. at 86. Proof of a defendant's wealth has generally been held admissible in proper cases for awards of punitive damages. Belli, *supra* note 11, at 12-13. When such damages are assessed to punish a defendant evidence of the defendant's wealth is relevant because an amount that would punish one man might be a small sum to another. *Id.*

[20] 27 Miss. at 88-89. Since the amount to be awarded is entirely within the province of the trier of fact, it cannot be disturbed unless it is "so apparently excessive as to evince passion and prejudice on their part." Yazoo & M.V.R.R. v. May, 104 Miss. 422, 426, 61 So. 449, 450 (1913).

[21] 27 Miss. at 85. *See supra* note 14.

[22] 101 Miss. 802, 58 So. 650 (1911).

[23] *Id.* at 803-04, 58 So. at 650.

[24] *Id.* at 804, 58 So. at 650. Plaintiff, Hines, requested both actual and punitive damages on the ground that defendant had committed an intentional trespass. *Id.*, 58 So. at 650.

[25] *Id.* at 805, 58 So. at 651. The chancellor appointed a master to determine what monetary amount would compensate the plaintiff for the damage to his trees. When the master's proposed sum exceeded the appraisal of actual damage to the trees, the chancellor viewed the excess amount as punitive and refused to award the recommended amount. *Id.* at 805-06, 58 So. at 650-51.

[26] *Id.* at 804, 58 So. at 650. Plaintiff argued on appeal that the chancellor had erred in failing to accept the master's recommendation as binding because such a recommendation should have the same effect and force as a jury verdict at law. *Id.* at 805, 58 So. at 651.

[27] *Id.* at 807, 58 So. at 651.

[28] *Id.* at 806, 58 So. at 651. "[I]mposition of this punishment lies as completely in the discretion of the chancellor as it does in the jury in cases tried by a jury." *Id.*, 58 So. at 651.

[29] 154 Miss. 691, 123 So. 861 (1929).

court again reviewed a chancellor's refusal to award punitive damages.[30] The plaintiff sought both actual and punitive damages in an attachment action in chancery after the defendant's agent had demolished the plaintiff's house and all the furniture therein.[31] The chancellor made a specific finding that the defendant's agent had acted in good faith, and therefore did not assess exemplary damages.[32] On the basis of this finding of good faith, the Mississippi Supreme Court affirmed the chancellor's decree,[33] stating that the chancellor did not abuse his discretion in refusing to assess punitive damages.[34] The *Neal* court reiterated the *Hines*[35] holding, that although punitive damages could properly be awarded in chancery court, such an award was one within the discretion of the finder of fact.[36]

Twenty-four years after the *Neal* decision, the supreme court reached a different conclusion in *Wilborn v. Balfour*.[37] The plaintiff in *Wilborn* brought an action in chancery court to have a warranty deed, which was executed in favor of the defendant, declared a deed of trust.[38] The plaintiff alleged that the defendant had fraudulently represented the document as a deed of trust to secure a loan.[39] The chan-

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[30] *Id.* at 696, 123 So. at 862.

[31] *Id.*, 123 So. at 862. Plaintiff held title to the lot on which her house stood pursuant to an unrecorded deed. Land records in the county clerk's office showed that the defendant, the Newburger Company, held title to the property. *Id.* at 697, 123 So. at 862. Defendant's agent determined that removing the house would enhance the property's value. He proceeded with demolition of the house in reliance on the record title, despite the fact that plaintiff's husband had informed him that plaintiff owned the property. *Id.* at 698, 123 So. at 863.

[32] *Id.* at 700-01, 123 So. at 864. The chancellor did award actual damages and confirmed plaintiff's title to the lot. *Id.* at 696, 123 So. at 862.

[33] *Id.* at 703, 123 So. at 865.

[34] *Id.* at 700, 123 So. at 864. The court stated that the chancellor's finding of good faith on the part of defendant's agent negated any suggestion of the wantonness or recklessness necessary to support a punitive damage award. *Id.*, 123 So. at 864.

[35] *See supra* notes 27-28 and accompanying text.

[36] *See* 154 Miss. at 699, 123 So. at 863. The court stated that the chancellor's refusal to award exemplary damages was reviewable only for abuse of discretion, and on appeal, the supreme court could not make a final decree awarding punitive damages. *Id.* at 699-700, 123 So. at 863. The court also stated that it could not, by way of reversal, order the chancellor to award punitive damages. *Id.* at 700, 123 So. at 863.

[37] 218 Miss. 791, 67 So. 2d 857 (1953).

[38] *Id.* at 793, 67 So. 2d at 858. Plaintiff, a mental incompetent who sued by next friend, also requested both actual and punitive damages. *Id.* at 796, 67 So. 2d at 859.

[39] *Id.* at 792, 67 So. 2d at 858. Defendant informed the plaintiff that she was signing a deed of trust, when in actuality it was a warranty deed. Defendant also encouraged the plaintiff not to read the documents she was signing. In reliance on the defendant's representations, plaintiff signed the deed for herself and for her husband. *Id.*, 67 So. 2d at

cellor concluded that fraud was present in the transaction and awarded punitive damages.[40] The supreme court reversed the chancellor's decree awarding punitive damages,[41] holding that it was improper to award such damages in a suit in equity even though punitive damages could have been awarded if the suit had been brought at law.[42] Emphasizing that a chancery court was one of equity and conscience, rather than a forum for revenge,[43] the court stated that although actual damages were awardable for the purpose of supplementing equitable relief, no punitive damages could be assessed by a chancery court in the absence of express statutory authority.[44]

In *Monsanto Co. v. Cochran*,[45] the supreme court adhered to the law of punitive damages announced in *Wilborn* but set out a new theory to support its reasoning.[46] The plaintiff sued in chancery court to have a lease cancelled on the basis of fraud and also requested an accounting and punitive damages.[47] Based on a finding of fraudulent conduct on the part of the defendants, the chancellor cancelled the lease

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860.

[40] *Id.* at 798-99, 67 So. 2d at 860. The chancellor also cancelled the warranty deed and awarded actual damages and attorney's fees to the plaintiff. *Id.*, 67 So. 2d at 860.

[41] *Id.* at 806-07, 67 So. 2d at 864. The award of attorney's fees was also reversed, but both cancellation of the deed and the award of actual damages were affirmed. *Id.*, 67 So. 2d at 864.

[42] *Id.* at 806-07, 67 So. 2d at 864. The court, with no reference to *Hines v. Imperial Naval Stores Co.* or *Neal v. Newburger Co.*, stated that it knew of no Mississippi cases allowing the imposition of punitive damages in chancery court absent statutory authority. 218 Miss. at 806, 67 So. 2d at 864.

[43] 218 Miss. at 805, 67 So. 2d at 863. The court quoted from Bush v. Gaffney, 84 S.W.2d 759, 765 (Tex. Civ. App. 1935): "[a] court of equity is a court of conscience, but not a forum of vengeance. It will make restitutions but not reprisals. It will fill full the measure of compensation, but will not overflow it with vindictive damages." 218 Miss. at 805, 67 So. 2d at 863.

[44] 218 Miss. at 805, 67 So. 2d at 863. The Mississippi Supreme Court was not without precedent from other states in adopting such a rule. *See* Mid-Continent Petroleum Corp. v. Bettis, 69 P.2d 346, 348 (Okla. 1937) (equity court not empowered under Oklahoma statute to award punitive damages); Bush v. Gaffney, 84 S.W.2d 759, 765 (Tex. Civ. App. 1935) (exemplary damages not authorized by statute in suit for rescission of conveyance and establishment of constructive trust). *See generally* Annot., 48 A.L.R. 947, 949-55 (1956) (review of jurisdictions which did not allow punitive damages in equity).

[45] 254 Miss. 399, 180 So. 2d 624 (1965).

[46] *See id.* at 404-05, 180 So. 2d at 626.

[47] *Id.* at 402, 180 So. 2d at 625. The issue arose when defendant's agent failed to turn in proper invoices for the rental amount due on a leased service station. *Id.* at 403-04, 180 So. 2d at 625.

and awarded both compensatory and punitive damages.[48] Reversing that portion of the chancellor's decree that awarded punitive damages,[49] the supreme court stated that the award was manifestly erroneous because punitive damages were generally not assessable in a court of equity.[50] The decision was grounded on the theory that the plaintiff had waived the capacity to recover damages that were not compensatory in character by suing in equity rather than at law.[51] In reaching its conclusion, the *Monsanto* court interpreted both *Hines v. Imperial Naval Stores Co.* and *Neal v. Newburger* as having adopted the rule that a court of equity was not empowered to award punitive damages.[52]

The exemplary damages issue was brought before the supreme court again in *Subscribers Casualty Reciprocal Exchange v. Totaro*,[53] in which the plaintiff filed suit in chancery court for specific performance of an insurance contract.[54] Holding that the defendant's delay in making disability payments to the plaintiff was inexcusable, the chancellor assessed punitive damages against the defendant.[55] On appeal, the supreme court reversed the award of punitive damages[56] and again stated that no punitive damages were recoverable because the chancery court lacked specific statutory authority to make such an award.[57] The court also reiterated the waiver theory, which was set out in *Monsanto*, as support for its decision.[58]

In *M.T. Reed Construction Co. v. Nicholas Acoustics and Spe-*

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[48] *Id.* at 404, 180 So. 2d at 626.

[49] *Id.*, 180 So. 2d at 626.

[50] *Id.*, 180 So. 2d at 626.

[51] *Id.* at 404-05, 180 So. 2d at 626.

[52] *Id.* at 405, 180 So. 2d at 626. In support of the proposition that Mississippi cases do not support awards of punitive damages in chancery court, the *Monsanto* court also cited Annot., 48 A.L.R.2d 947 (1956). 254 Miss. at 405, 180 So. 2d at 626. The Annotation actually identifies Mississippi as a jurisdiction in which the question whether punitive damages may be awarded in equity is unsettled. *See* 48 A.L.R. 2d at 958-59.

[53] 370 So. 2d 1342 (Miss. 1979).

[54] *Id.* at 1342. Plaintiff was the holder of a total disability insurance policy, part of which provided for payments of fifty dollars per week for a maximum of two hundred weeks if the holder were disabled. Following plaintiff's debilitating injury, the defendant insurance company delayed payment of the weekly amount, although it promptly paid other benefits under the policy. *Id.*

[55] *Id.* The chancellor awarded the plaintiff $10,000 in punitive damages and $1,500 in attorney's fees. *Id.*

[56] *Id.* The court also reversed the portion of the chancellor's decree which awarded attorney's fees, stating that these were not recoverable in chancery court because no statute authorized such an award in equity. *Id.*

[57] *Id.*

[58] *Id.* at 1343. *See supra* text accompanying note 51.

cialty Co.,[59] the Mississippi Supreme Court approved a complicated procedure by which the chancery court's lack of power to award punitive damages could be circumvented.[60] The plaintiff brought suit against the defendant in circuit court for breach of contract and requested both actual and punitive damages.[61] Finding that the questions pertaining to the contract at issue involved complex mutual accounts, the circuit court transferred all issues to the chancery court, except the punitive damages issue.[62] After the chancery court proceedings were concluded in the plaintiff's favor,[63] the circuit court resumed its jurisdiction over the matter and assessed punitive damages against the defendant based on a finding that there had been a malicious breach of contract.[64] On appeal, the supreme court reversed the circuit court's order awarding punitive damages,[65] but the court did so only because it found no malicious breach of contract sufficient to justify an assessment of punitive damages.[66] The procedure employed by the circuit court in *Reed* thereby was implicitly approved. In *Thompson v. First Mississippi National Bank*,[67] the plaintiff filed a suit involving a disputed credit life insurance policy in circuit court and requested both actual and punitive damages.[68] The circuit court transferred the case to

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[59] 387 So. 2d 98 (Miss. 1980).

[60] *Id.* at 101.

[61] *Id.* at 98. Plaintiff subcontractor alleged a malicious breach of contract on the part of the defendant prime contractor. *Id.* at 99.

[62] *Id.* at 98. The issues were transferred to chancery court pursuant to MISS. CONST. art. VI, § 161. Plaintiff then filed its bill of complaint in chancery court. 379 So. 2d at 309. *See* MISS. CODE ANN. § 11-1-39 (1972) (plaintiff must file complaint with transferee court within 30 days of transfer or face dismissal).

[63] The chancellor's decree, substantially in favor of the plaintiff, was affirmed by the Mississippi Supreme Court except as to the award of prejudgment interest. *See* M.T. Reed Constr. Co. v. Nicholas Acoustics and Specialty Co., 379 So. 2d 308, 313 (Miss. 1980).

[64] 387 So. 2d at 98. The chancellor had entered a decree awarding actual damages to the plaintiff. At trial in the circuit court on the exemplary damages issue, a jury verdict of $225,000 in punitive damages was entered in favor of the plaintiff. *Id.*

[65] *Id.* at 101.

[66] *Id.* Quoting Aetna Casualty & Surety Co. v. Steele, 373 So. 2d 797, 801 (Miss. 1979), the court stated that " '[t]he rule in Mississippi is settled that punitive damages are not recoverable for a breach of contract unless such breach is attended by intentional wrong, insult, abuse, or such gross negligence that amounts to an independent tort. . . .' " 387 So. 2d at 100.

[67] 427 So. 2d 973 (Miss. 1983).

[68] *Id.* at 974. Plaintiff, Thompson, and her husband procured a loan of $40,000 from the defendant bank. A credit life insurance policy was also obtained by the bank from their co-defendant, Mutual Savings Life Insurance Co., for the purpose of covering the loan's repayment in the event of Mr. Thompson's death. Plaintiff alleged that two days

chancery court on all issues[69] because a complex accounting was involved.[70] The chancery court granted the defendant's motion to dismiss after the plaintiff filed no pleadings in chancery court.[71] On appeal by the plaintiff, the supreme court reversed,[72] holding that the transfer to chancery court was in error and that the circuit court should have retained jurisdiction over the whole cause of action.[73] The court reasoned that because the chancery court had no power to hear punitive damage claims, the transfer to chancery court had deprived the plaintiff of the substantive right to litigate the punitive damage issue.[74] Although the circuit court could validly have employed the *Reed* procedure, the supreme court expressly recognized that procedure as inefficient and cumbersome.[75]

While the Mississippi Supreme Court was continuously holding that punitive damages were not recoverable in suits in equity,[76] other jurisdictions were beginning to move in the opposite direction. In *In-*

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preceding her husband's death, she had paid to the bank a sum large enough to renew both the note representing the loan and the life insurance policy. The bank, however, failed to renew the insurance policy, and the debt was left undischarged after the death of Mr. Thompson. Plaintiff sought to have the debt declared discharged. *Id.*

[69] *Id.* at 974-75.

[70] *Id.* at 974.

[71] *Id.* at 975. Defendant's motion to dismiss was made pursuant to MISS. CODE ANN. § 11-1-39 (1972). 427 So. 2d at 975. *See supra* note 62.

[72] 427 So. 2d at 975.

[73] *Id.* at 975-76. The court stated that "where there is in the case one issue of exclusive law cognizance (e.g., the punitive damages issue), the circuit court may in its discretion retain jurisdiction and hear the entire cause, even though there may be other issues which arguably fall within chancery court subject matter jurisdiction." *Id.* at 976.

[74] *Id.* at 976. By transfer of the action to chancery court, the plaintiff was also deprived of the right to a jury trial. *Id.*

[75] *Id.* at 975.

[76] *See, e.g.,* Gulf Steamship Cos. v. Polk, 370 So. 2d 1348, 1351 (Miss. 1979) (punitive damages not awardable in equitable action to recover disability benefits and attorney's fees); Carl v. Craft, 258 So.2d 237, 241 (Miss. 1972) (no punitive damages in chancery court suit to enjoin foreclosure of a deed of trust); Kemp v. Lake Serene Property Owners Ass'n, 256 So. 2d 924, 926 (Miss. 1971) (no statutory authority giving chancery courts the power to award punitive damages); Avant v. Whitten, 253 So. 2d 394, 396-98 (Miss. 1971) (chancery court not empowered to assess punitive damages when rescinding contingent fee contract based on outcome of divorce trial); Bridges v. Land, 252 So. 2d 209, 211 (Miss. 1971) (no punitive damages in equitable action for breach of contract and specific performance); Brent v. Cox, 246 So. 2d 552, 553 (Miss. 1971) (no exemplary damages in equitable attachment action arising from trespass and damage caused thereby); Capital Elec. Power Ass'n v. McGuffee, 226 Miss. 227, 246, 83 So. 2d 837, 844 (1955) (punitive damages not assessable in equity court against electric company that unreasonably discontinued plaintiff's service).

ternational Bankers Life Insurance Co. v. Holloway,[77] a corporation brought suit in equity against some of its former officers and directors for fraud and conspiracy.[78] Although the Texas court reversed a judgment for the plaintiffs and remanded for a new trial on the issue of damages,[79] the court held that the recovery of consideration paid as the result of fraud would serve as a basis for an assessment of exemplary damages.[80] The election of the plaintiff to sue in equity did not preclude recovery of exemplary damages.[81] The Iowa courts dealt with the issue of awarding punitive damages in equitable actions in *Charles v. Epperson & Co.*,[82] a shareholder's derivative action against a director for fraudulent appropriation of corporate funds.[83] The court held that punitive damages were properly assessed by the equity court based upon a finding of intentional acts of fraud.[84] The court stated that the modern trend was to allow equity courts to award exemplary damages, especially when both legal and equitable relief were administered by the same court.[85]

In the instant case, the Mississippi Supreme Court abandoned the rule excluding the power to award punitive damages from the subject matter jurisdiction of chancery courts,[86] finding the rule to be illogical and historically unsupported.[87] The court reasoned that because cases of fraud historically were within the jurisdiction of chancery courts,[88]

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[77] 368 S.W.2d 567 (Tex. 1963).

[78] *Id.* at 570. Plaintiffs alleged that defendants breached their fiduciary duties to plaintiffs, mismanaged and misappropriated corporate funds, and took advantage of corporate opportunities. *Id.*

[79] *Id.* at 584. At trial, the jury had found that the defendants entered into a concerted plan to realize a personal profit through sales of stock and real estate. *Id.* at 571.

Based on the jury's findings, the court entered judgment in favor of the plaintiff for $228,979.70 in actual damages and $339,714.24 in exemplary damages. *Id.* at 570.

[80] *Id.* at 583-84.

[81] *Id.* at 584.

[82] 137 N.W.2d 605 (Iowa 1965).

[83] *Id.* at 615.

[84] *Id.* at 618. Exemplary damages in the amount of $7500 were awarded. *Id.* at 619.

[85] *Id.* at 618. *Cf.* Bryson v. Bramlett, 321 S.W.2d 555, 557 (Tenn. 1958) (punitive damages awarded in separate equity court for wrongful levy under a void garnishment).

[86] 431 So. 2d at 463 (majority opinion by Robertson, J.). The court specifically stated that its decision was not based on principles of the chancery courts' pendent jurisdiction. *Id.* at 464. *Cf.* Shaw v. Owen Gin, 229 Miss. 126, 133, 90 So. 2d 179, 181 (1956) (chancery court has pendent jurisdiction over legal issues once jurisdiction taken over any one equitable issue).

[87] 431 So. 2d at 459 (majority opinion by Robertson, J.).

[88] 431 So. 2d at 461 (majority opinion by Robertson, J.). *See* 1 HOLDSWORTH, A HISTORY OF ENGLISH LAW 454-59 (7th ed. 1956) (fraud historically an important area of equity jurisdiction); 1 SYMONS, POMEROY'S EQUITY JURISPRUDENCE § 140 (5th ed. 1941) (eq-

and because fraud had become an accepted ground for supporting a punitive damage award,[89] chancellors should have authority to give comprehensive relief in such cases.[90] Moreover, punitive damages have long been recognized as sanctions consistent with public policy[91] and the power to award relief consistent with that public policy should be extended to the chancery courts.[92] The court reasoned further that the principle of stare decisis did not require retention of the rule,[93] since the power to award punitive damages is remedial in nature,[94] and abandonment of the present rule would not affect the ability of private parties to structure their conduct to comply with substantive rules of law.[95]

In a dissenting opinion, Justice Broom stated that the majority decision abridged the right of parties to have punitive damages issues tried by a jury.[96] He argued that such a change in Mississippi law would be better accomplished through legislative action.[97]

In the *Tideway* decision, the Mississippi Supreme Court follows

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uity courts' jurisdiction concurrent with law courts in cases of fraud).

[89] 431 So. 2d at 461 (majority opinion by Robertson, J.).

[90] *Id.* at 461-62. One of the basic maxims of equity stresses that chancery courts prefer to do complete justice rather than by halves. GRIFFITH, MISSISSIPPI CHANCERY PRACTICE § 36 (2d ed. 1950).

[91] 431 So. 2d at 460 (majority opinion by Robertson, J.).

[92] *Id.*

[93] 431 So. 2d at 406-07 (majority opinion by Robertson, J.). The court cited several "evils" that would be involved in adhering to the old rule, such as use of the inefficient *Reed* procedure.

Retaining the rule would also result in the continuation of forum shopping and "unseemly tactical maneuvering" by the parties and would further enable wrongdoers to escape their just deserts. *Id.* at 407. The court, however, stressed that the new rule should be applied with care, using the standards applicable in circuit court, as its object was not to encourage a flood of punitive damage claims in chancery court. *Id.* at 11 n.1. "Punitive damages are assessed as an example and warning to others and should be allowed only with caution and within narrow limits." Standard Life Ins. Co. v. Veal, 354 So. 2d 239, 247 (Miss. 1977). The court noted a possible need to restrict the standard used to assess punitive damages "to assure such damages are given only to those truly public spirited plaintiffs." 431 So. 2d at 460 n.1 (majority opinion of Robertson, J.). "[Punitive] damages ought to be awarded only where the plaintiff, at great trouble and personal expense has rendered a public service by bringing the wrongdoer to account." *Id.* at 461.

[94] *Id.* at 465.

[95] *Id. Cf.* Moragne v. States Marine Lines, Inc. 398 U.S. 375, 403-04 (1970) (overruling past denials of wrongful death recovery in maritime law does not threaten ability to structure behavior).

[96] 431 So. 2d at 467-68 (Broom, J., dissenting).

[97] *Id.*

the modern trend[98] and narrows the difference in subject matter jurisdiction between the chancery and circuit courts. A basic strategic problem is now solved for plaintiffs who have equitable claims containing grounds for possible punitive damage awards. Such plaintiffs previously faced uncertainty as to the court in which their case would be tried after the initial circuit court forum was chosen. A circuit court might retain the whole case, as mandated in *Thompson*,[99] or it might employ the *Reed* procedure,[100] ignoring notions of judicial economy and forcing the parties to litigate one case in two forums. Plaintiffs will now be certain that they can receive full relief with the convenience of litigating in one court — the chancery court. Any fear of award of unwarranted punitive damages in chancery courts is unfounded because chancellors will be guided by those standards currently used in circuit court.[101] Furthermore, language in the *Tideway* opinion, which must be seen as dictum, suggests the possibility of future restrictions on the present standard for the award of punitive damages.[102] The Mississippi Supreme Court, in *Tideway*, has enabled the chancery courts to offer a forum in which complete justice can be done.

Janet G. Arnold

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[98] *See supra* notes 76-85 and accompanying text.
[99] *See supra* notes 67-75 and accompanying text.
[100] *See supra* notes 59-66 and accompanying text.
[101] *See supra* note 93.
[102] *See supra* note 93.

MORTGAGES—MORTGAGOR'S REMEDIES—UNCONSCIONABLE WINDFALL FROM RESALE OF SECURITY IMMEDIATELY AFTER MORTAGEE'S PURCHASE AT FORECLOSURE SALE GIVES MORTGAGOR A RIGHT TO DAMAGES

Trustors[1] filed a bill of complaint in the Chancery Court of Lauderdale County, Mississippi, seeking to have set aside[2] a trustee's sale[3]

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[1] The trustors, Marshall and Ester Spears, borrowed from Central Financial Services, Inc., the principal amount of $1,250, giving in exchange their promissory note and a deed of trust to certain realty they owned. Interest, credit insurance, and loan origination fees brought the balance of the secured indebtedness to $1,797.30. Mr. Spears then loaned one-half of the principal amount to his son. When Mr. Spears and his son were unable to agree on a repayment schedule for the son, the note went into arrears. After Central Financial Services, Inc., began foreclosure proceedings, Mr. Spears paid all delinquent installments plus all costs so far incurred by the trustee in bringing the foreclosure proceedings; this reinstated the debt. (*See* MISS. CODE ANN. § 89-1-59 (Supp. 1982) (payment by debtor of delinquent indebtedness and expenses incurred by trustee in seeking foreclosure reinstates the debt notwithstanding any acceleration clause.)) The disagreement over repayment responsibilities continued, and again the debt fell into arrears. This time, foreclosure proceedings were concluded. Two days after the foreclosure sale, the trust deed beneficiary, who had purchased the security at the trustee's sale, notified Mr. and Mrs. Spears to vacate the premises. Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403, 403 (Miss. 1983).

[2] In Mississippi, a suit to have a foreclosure sale set aside and title confirmed in the mortgagor is properly filed in the chancery court in the county in which the land, or some part of it, is located. *See* Federal Land Bank v. Robinson, 160 Miss. 546, 561, 134 So. 180, 185 (1931) (suit to set aside foreclosure sale presents an equitable claim); MISS. CONST. art. 6, § 159 (chancery court has full jurisdiction over all matters in equity); MISS. CODE ANN. § 11-11-3 (1972)(proper venue for proceedings in rem). A mortgagor aggrieved by a defective foreclosure sale may bring an action in equity to set aside the sale or at law for damages. *Federal Land Bank*, 160 Miss. at 561, 134 So. at 185.

[3] The trustee conducted the foreclosure sale on October 12, 1979, in strict compliance with all statutory requirements for foreclosure under a power of sale in Mississippi. Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403, 403, 405 (Miss. 1983). The beneficiary under the deed of trust, Central Financial Services, Inc., was the only bidder. Its bid of $1,458.86 represented the unpaid indebtedness plus the costs of the foreclosure. *Id.* at 403.

Mississippi was among the first states to recognize the validity of the power of sale as a device for cutting off a mortgagor's equity of redemption. *See* Comment, *Due Process Problems of Mississippi Power of Sale Foreclosure*, 47 MISS. L.J. 67, 69 (1976). That recognition came in the case of Sims v. Hundley, 3 Miss. (2 Howard) 896 (1838), in which a debtor sought to enjoin the sale of a security at an advertised public sale by a trustee to whom the debtor had entrusted the security for the benefit of the secured creditor. *Id.* at 897-98. The deed of trust has since become the preferred mortgage instrument in Mississippi. *See* Committee on Mortgage Law and Practice, *Cost and Time Factors in Foreclosure of Mortgages*, REAL PROP. PROB. & TR. J. 413, 414 (1968).

of mortgaged realty to the mortgagee[4] and all subsequent resales of that same property.[5] The complaint alleged that the price brought by the foreclosure sale was inadequate.[6]

The chancellor dismissed the complaints against all named defendants except the mortgagee.[7] With guidance from the Mississippi Supreme Court,[8] the chancellor found the price paid by the mortgagee at the foreclosure sale to be so inadequate as to provide sufficient ground for granting relief to the mortgagor even though the foreclosure sale in all other respects had been properly concluded.[9] Rather than set aside

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In Mississippi, the deed of trust is executed and foreclosed upon as follows: The debtor conveys whatever title he has in the specified security to a trustee who holds title in trust for the benefit of the creditor until the debt is extinguished. *See* MISS. CODE ANN. §§ 89-1-61, 89-5-37 (1972) (form requisites for deeds of trust); § 89-1-49 (1972) (payment of debt extinguishes mortgage/trust). If the debtor defaults, the beneficiary notifies the trustee to sell the property to the highest bidder at an advertised public sale held in the county in which the land, or some part of it, is located. *See* MISS. CODE ANN. § 89-1-55 (1972) (procedural requirements for sale under a power). Upon conclusion of his public sale, the trustee executes a deed conveying to the purchaser whatever title he had. *See* MISS. CODE ANN. § 89-1-53 (1972) (form requisites for trustee's deed); Abbott, *Some Basic Priority Problems in a Land Development Project in Mississippi with Emphasis Upon Power of Sale Foreclosure Procedures,* 50 MISS. L.J. 665, 680-81 (1979) (beneficiary is typically the only bidder). The trustee then remits the sale proceeds to the beneficiary to the extent of the unpaid secured indebtedness, and the surplus, if any, is remitted to the debtor. Reese v. Ivey, 324 So. 2d 756, 757 (Miss. 1976).

[4] Since the status of the beneficiary under a deed of trust is analogous to that of a mortgagee, the terms are often used interchangably and will be throughout this note for the sake of convenience and clarity. For the same reason, the terms trustor and mortgagor will be so used. For a brief comparison of mortgages and deeds of trust, see G. OSBORNE, G. NELSON, & D. WHITMAN, REAL ESTATE FINANCE LAW § 1.6 (1979).

[5] Twelve days after purchasing the security at the trustee's sale for the amount of the unpaid indebtedness ($1,458.86), Central Financial Services, Inc., sold the property to Joe Stewart and Earl Aycock for $4,000. *Central Financial Services, Inc. v. Spears,* 425 So. 2d at 403. Four months later Roger C. Henderson purchased the property from Stewart and Aycock for $6,500. *Id.* at 404.

[6] *Id.* at 404. The complaint asserted that fair market value of the property was $7,000. *Id.*

[7] *Id.* The complaint had named as defendants: Central Financial Services, Inc., Joe Stewart, Earl Aycock, Roger Henderson, and Thomas Bourdeaux; Bourdeaux had served as trustee. *Id. See supra* note 5.

[8] The chancellor had originally sustained defendant's demurrers, dismissing the claim altogether. In an unpublished opinion, the supreme court reversed and remanded for trial on the merits, noting that *if* the allegations of $7,000 fair market value were proven, the foreclosure sale price was indeed "so grossly inadequate as to shock the conscience." *Id.* For discussion of the origin of the Mississippi doctrine that a trustee's sale may be set aside when the price is so inadequate as to "shock the conscience," see *infra* notes 13-19 and accompanying text.

[9] *See id.* at 404-05. *But cf.* Tarrant Sav. Ass'n v. Lucky Homes, Inc., 390 S.W.2d

a sale of realty which, by the time of trial, had been twice resold,[10] the chancellor ordered the mortgagee to pay the aggrieved mortgagor as damages the difference between fair value of the property at the time of the foreclosure sale and the unpaid balance of the secured indebtedness.[11]

On appeal, the Mississippi Supreme Court, *held*, affirmed as modified.[12] Realization of an unconscionable windfall by the mortgagee from resale of the security to a bona fide purchaser immediately after the mortgagee has bought it at a foreclosure sale gives the mortgagor a right to damages in the amount of the mortgagee's profit from the resale. *Central Financial Services, Inc. v. Spears*, 425 So. 2d 403 (Miss.

473, 475 (Tex. 1965) (finding an almost identical bid price—fair value disparity permissible under Texas law because no evidence of attendant inequitable conduct by the mortgagee was adduced at trial); *infra* note 86 (discussion of Texas cases).

[10] *Id.* at 403-04; *see supra* note 5. For a more recent indication of how the rights of a mortgagee who purchases at a questionable foreclosure sale may be affected when bona fide purchasers have intervened by the time of trial, see Peoples Bank and Trust Co. v. L & T Developers, 434 So. 2d 699 (Miss. 1983).

[11] 425 So. 2d at 404. Based on the evidence presented at trial, the chancellor found fair value at the date of foreclosure to have been $6,000. *Id.* Subtracting from this figure the amount of the unpaid debt, the mortgagee was required to pay the mortgagor damages of $4,541.14. *See id.* Although the mortgagee had received only $4,000 from its resale of the property, the damages award was equal to the surplus that the trustee would have remitted to the mortgagor had the foreclosure sale brought $6,000. *See id.* at 403, 405. *See generally* Reese v. Ivey, 324 So. 2d 756, 757 (Miss. 1976) (trustee held liable for failure to pay mortgagor surplus of foreclosure sale proceeds over the foreclosing mortgagee's claim).

[12] The Mississippi Supreme Court agreed in principle with the remedy fashioned by the chancellor, but it modified the damages award as follows:

	Chancellor	Miss. Sup. Ct.
Fair Market Value of the Security on Foreclosure Sale Date	$6,000.00	$4,000.00
LESS:		
Unpaid Indebtedness	1,458.86	1,458.86
Judgment Lien against Security Paid by Mortgagee		30.00
Contract Rate of Interest From Date of Foreclosure Sale to Date of Resale		13.51
Damages to Mortgagor	$4,541.14	$2,497.63

425 So. 2d at 405.

1983).

The seminal case of *Weyburn v. Watkins*[13] presented the Mississippi Supreme Court in 1907 with an opportunity to invalidate for inadequacy of bid price alone a foreclosure sale executed pursuant to a power of sale.[14] In *Weyburn*, the mortgagee bought the property at the foreclosure sale for about forty percent of the price at which it had been purchased less than one year earlier.[15] The court declared the settled law of Mississippi[16] to be that a trustee's sale, in all other respects properly conducted, would not be judicially invalidated for mere inadequacy of bid price "*unless* the inadequacy is such as to shock the conscience."[17] Turning to the merits of the case, the court found the bid

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[13] 90 Miss. 728, 44 So. 145 (1907).

[14] *See id.* at 735, 44 So. at 145, 146. The *Weyburn* opinion was not the first published opinion by a Mississippi court to discuss judicial invalidation of a conveyance for unconscionable inadequacy of sale price at a trustee's sale. The Mississippi Superior Court of Chancery addressed this issue in Newman v. Meek, 1 Freem. Ch. 441, 458-59 (Miss. Super. Ct. Ch. 1844). There the court said:

> [Inadequacy of sale price as ground of itself for setting aside a sale] has been generally made to private contracts between vendor and purchaser, and has been held not to extend to sales by auction, *unless connected with some other circumstances going to establish fraud.* [Citations omitted]. One of the reasons given why the rule is not applicable in sales at auction, is, that there can be no treaty between vendor and purchaser, and therefore no opportunity is afforded for fraud or imposition on the part of the purchaser.
>
> Another more satisfactory reason is, that sales of that description, where they are openly and fairly conducted, furnish the best evidence of the market price of the thing sold.

Id. (emphasis added).

Cf. Biddle v. National Old Line Ins. Co., 513 S.W.2d 135, 138 (Tex. Civ. App. 1974) (Texas courts will not consider adequacy of sale price unless some evidence of inequitable conduct or procedural irregularity has been presented); *see infra* note 86 (discussion of Texas cases).

[15] *See* 90 Miss. at 733-35, 44 So. at 145. Watkins, who had been the purchaser at the foreclosure sale, was the original mortgagee's assignee. The original mortgagor had purchased the land in 1897 for $3,960, of which $3,135 consisted of notes secured by a deed of trust. Weyburn purchased the property in 1901, assuming the debt, and conveyed it three months later to Gregory, who also assumed the mortgage. When Gregory defaulted within the year, Watkins foreclosed, purchased at the foreclosure sale for $1,680, and looked up the chain of assumptions for a solvent defendant against whom he could assert the deficiency. When Watkins obtained a deficiency judgment against Weyburn for $2,060, Weyburn sued to have the sale set aside. *Id.*, 44 So. at 145.

See generally McLeod v. Building & Loan Ass'n, 168 Miss. 457, 461-63, 151 So. 151, 151-52 (1933) (effect of foreclosure on rights derived from the chain of assumptions).

[16] 90 Miss. at 735, 44 So. at 146. No prior cases were cited. *See id.* For an earlier case dealing with this question, see Newman v. Meek, 1 Freem. Ch. 441, 448-59 (Miss. Super. Ct. Ch. 1844), discussed *supra* note 14.

[17] 90 Miss. at 735, 44 So. at 146 (emphasis added). Today, a trustee's sale may be

price in question, which was "about forty percent of its actual value," to be low but apparently not shocking to the conscience.[18] While it created in *Weyburn* an exception fully capable of engulfing its rule against setting aside sales for inadequacy of bid price,[19] the court apparently limited its application to cases in which the bid price was less than forty percent of fair market value.[20]

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properly concluded without even published notice to a person situated as was Weyburn. *See* MISS. CODE ANN. § 89-1-55 (1972) (statute requires only the *original* mortgagor to be named in the public notices of an impending foreclosure sale); Abbott, *supra* note 3, at 679 n. 44 (detailed discusison of the development of the rule).

[18] *See* 90 Miss. at 735, 44 So. at 146. The exact percentage is indeterminable since no mention is made in the published opinion of what fair market value of the security was in the mind of the court. Futhermore, the only purchase price given is that paid by the original mortgagor. *See id.* at 733-36, 44 So. at 145-46; *see also supra* note 15. *But see infra* note 20.

[19] The traditional rule followed by Mississippi courts generally was that inadequacy of bid price at public sale was a ground for setting aside the sale only if proof of the inadequacy was accompanied by proof of inequitable conduct by the purchaser. *See* Newman v. Meek, 1 Freem. Ch. 451, 458-59 (Miss. Super. Ct. Ch. 1844) (inadequacy of sale price not ground for setting aside the sale "unless connected with some other circumstances going to establish fraud"); *supra* note 14; *see also* Elmslie v. Mayor, 35 So. 201, 202 (Miss. 1903) (officially unreported decision) (same proposition). In allowing inadequacy of sale price alone (without attendant inequities) to constitute a ground for setting aside the sale when that inadequacy "shocks the conscience," *Weyburn* created an exception to the traditional rule. *See* 90 Miss. at 735, 44 So. at 146.

Since *Weyburn* was decided, a discernible line of cases has developed as aggrieved mortgagors asserted the exception in a variety of contexts, offensively and defensively. The principal offensive use has been by way of suit by the aggrieved mortgagor in chancery court to confirm title in himself. *See* Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403, 404 (Miss. 1983); Myles v. Cox, 217 So. 2d 31, 32 (Miss. 1968); Harris v. Bailey Ave. Park, 202 Miss. 766, 783, 32 So. 2d 689, 690 (1947); Hardin v. Grenada Bank, 182 Miss. 689, 699-700, 180 So. 805, 806 (1938); Hesdorffer v. Welsh, 127 Miss. 261, 261-63, 90 So. 3, 3-4 (1921). Defensively, the exception has been offered as support for pleas in general issue and for pleas in recoupment to avoid deficiency judgments. *See* Rains v. Thorp Fin. Corp., 250 Miss. 320, 324, 165 So. 2d 151, 152 (1964) (general issue by chattel mortgagor); Home Owners Loan Corp. v. Wiggins, 188 Miss. 750, 758, 195 So. 339, 340 (1940) (general issue); Wheeler v. Cleveland St. Bank, 174 Miss. 542, 549, 164 So. 400, 401 (1935) (recoupment); National Bank v. Gorenflo, 173 Miss. 646, 651, 160 So. 911, 912 (1935) (same); Federal Credit Co. v. Boleware, 163 Miss. 830, 833-36, 142 So. 1, 1-2 (1932) (same by implication); Federal Land Bank v. Robinson, 160 Miss. 546, 551, 134 So. 180, 181 (1931) (same).

[20] It is noteworthy that the allegedly inadequate bid in *Weyburn* was actually 42% of the *original* mortgagor's purchase price. *See* 90 Miss. at 733, 44 So. at 145-46. *See also supra* notes 15 and 18.

In Harris v. Bailey Ave. Park, Inc., 202 Miss. 776, 32 So. 2d 689 (1947), the supreme court, citing *Weyburn*, found a foreclosure sale price adequate which was, at worst, 42% of fair value. The bid price had been only $1,000, but any purchaser took the property subject to prior liens of $11,508. Valuation testimony ranged from $12,000 to $30,000.

Fourteen years passed before the court had occasion to clarify the *Weyburn* exception.[21] The facts of *Hesdorffer v. Welsh*[22] presented an appropriate situation for judicial invalidation of a foreclosure sale for inadequacy of bid price alone. Hesdorffer, the beneficiary under a deed of trust, purchased the mortgaged realty for $400[23] at a procedurally defective foreclosure sale.[24] The defects in Hesdorffer's title apparently went undetected until a sale of the land to Wood for $1,200 was attempted three years later.[25] At a second, curative trustee's sale, Hesdorffer purchased the security for $100, and then conveyed it to Wood according to their original agreement.[26] Noting the $1,200 resale price and trial testimony, the supreme court held that the $100 foreclosure sale price warranted the chancellor's action in setting aside the sale for

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Therefore, even assuming adoption by the court of $30,000 as fair value, $12,508 is 42% of that amount. *See id.* at 787-89, 32 So. 2d at 691-93. *See also* Home Owners Loan Corp. v. Wiggins, 188 Miss. 750, 757-59, 195 So. 339, 340-41 (1940) (court declared bid to be 50% of fair value and adequate); Wheeler v. Cleveland St. Bank, 174 Miss. 542, 553, 164 So. 400, 402 (1935) (bid plus prior liens equal to 60% of fair value held adequate).

[21] During the intervening period, the Mississippi Supreme Court used an inadequacy of price doctrine similar to that set forth in *Weyburn* in other contexts: In Baldwin v. Anderson, 103 Miss. 462, 60 So. 578 (1913), Baldwin conveyed to Glover land worth at least $1,000 in exchange for $10 cash and Glover's assumption of a $350 promissory note bearing 10% interest (payable annually); the note was due three and one-half years later. The deed recited in full the consideration given by Glover. As an additional inducement to convey, Glover had promised the elderly Mrs. Baldwin that she would be clothed, fed, and allowed to live on the land. Glover conveyed to Anderson shortly thereafter for $1,000, and Anderson asserted his title against Baldwin. *Id.* at 464-65, 60 So. at 579. The court declared the *recited* consideration so "grossly inadequate" as to put Anderson upon inquiry of possible defects in Glover's title. The court noted Anderson's own testimony that $1,000 was a fair price for the land. The effect of such a determination would be to deny Anderson the protection traditionally afforded a bona fide purchaser. *Id.*, 60 So. at 580.

In Bratton v. Graham, 146 Miss. 246, 111 So. 353 (1927), the doctrine was asserted to invalidate a sheriff's sale. In *Bratton*, the judgment lienee's extra-judicial statements acknowledged the security to be worth at least $12,000. Testimony adduced at trial set the value as high as $25,000. The lienee had purchased the debtor's land at a sheriff's sale for $600 (2% of the high estimate and 5% of the value acknowledged by the lienee). The supreme court made particular note of the lienee's extra-judicial acknowledgment in setting the sale aside. 146 Miss. at 259, 111 So. at 356. *See also* Industries Sales Corp. v. Reliance Mfg. Co., 243 Miss. 463, 469, 138 So. 2d 484, 487 (1962) (power of a court to set aside a *sheriff's* sale for inadequacy of sale price alone is incidental to the court's power to control its own processes).

[22] 127 Miss. 261, 90 So. 3 (1921).

[23] *Id.* at 263, 90 So. at 4.

[24] *Id.* at 269, 90 So. at 6.

[25] *See id.* at 263, 266, 90 So. at 4-5.

[26] *Id.* at 264, 90 So. at 4.

inadequacy of price.[27] The opinion gave no guidance as to how much weight a trial court should attach to resale prices of mortgaged property in arriving at a value against which the bid price would be compared for inadequacy,[28] but when read with *Weyburn*, the *Hesdorffer* decision seemed to indicate that the threshold of unconscionability lay between eight and forty percent of fair value.[29]

Instead of damages or judicial invalidation of the trustee's sale, the mortgagor in *Federal Land Bank v. Robinson*[30] sought recoupment[31] on the ground of inadequacy of bid price.[32] The mortgagee had

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[27] *Id.* at 270, 90 So. at 6. Apparently seeking to have the amounts paid at both foreclosure sales considered together, Hesdorffer's attorney testified that if the first foreclosure sale was void, the $100 paid at the second sale was a grossly inadequate price. *Id.*

[28] *Id.* It appears likely that Hesdorffer, the mortgagee, worsened his position when he purchased at the second sale for only $100. Had he reentered a bid of $400, which he had bid in the first sale, he would have purchased the security at one-third of the resale price, which might not have shocked the conscience of the court at all. *See supra* text accompanying notes 23-26; *cf.* Weyburn v. Watkins, 90 Miss. 728, 735, 44 So. 145, 146 (1907) (refusing to invalidate foreclosure where mortgagee bought for "about forty per cent." [sic] of the land's "actual value"). The *Hesdorffer* court merely stated that the chancellor's finding that the $100 sale price was unconscionably inadequate was a proper decision since "the property had recently been sold for a consideration of $1,200 cash, . . ." 127 Miss. at 270, 90 So. at 6.

[29] *Compare Hesdorffer*, 127 Miss. at 270, 90 So. at 6 (foreclosure bid amounting to 8% of private sale price so inadequate as to void foreclosure) *with Weyburn*, 90 Miss. at 735, 44 So. at 146 (foreclosure sale not set aside when price was "about" 40% of actual value). Support for a conclusion that the bid price found adequate in *Weyburn* was 42% of an earlier private purchase price can be found at *supra* notes 15, 18, and 20 and accompanying text.

It seems clear that extremely low bids, like that in *Hesdorffer*, will not survive the scrutiny of Mississippi courts. *See, e.g*, Peoples Bank & Trust Co. v. L. & T. Developers, Inc., 434 So. 2d 699 (Miss. 1983) (Robertson, J., commenting that bid prices of 2.63% and 4.65% of estimated fair market value are so shockingly inadequate to make it difficult to see how purchasers could justify their conduct); Bowers v. Fields, 148 So. 358, 358 (Miss. 1933) (officially unreported decision) (bid of no more than 2% of estimated value declared unconscionably inadequate and sale set aside); *cf.* Bratton v. Graham, 146 Miss. 246, 259, 111 So. 353, 356 (1927) (judgment lienee's bid of 2% to 5% of fair value at sheriff's sale held unconscionably inadequate).

In *Bowers v. Fields*, the mortgagee bid five dollars for property the court said "was worth, at least, $260 in excess of prior [first] mortgage . . . ." This value had been testified to by the mortgagee himself. 148 So. at 358. Interestingly, the Mississippi Supreme Court specifically directed that the opinion was "[n]ot to be reported in State Reports." [sic] *Id.*

[30] 160 Miss. 546, 134 So. 180 (1931).

[31] *Id.* at 561, 134 So. at 185. Recoupment, a defense available only to defendants sued at law for breach of contract, operated to reduce the plaintiff's recovery by the amount of pecuniary loss suffered by the defendant as a result of the plaintiff's breach of independent covenants of the same contract. Recoupment's similarity to set-off went no

purchased the mortgaged realty for $5,000 at the trustee's sale when, according to testimony, the property was worth between $35,000 and $60,000.[33] Application of the foreclosure sale proceeds of $5,000 to the secured indebtedness left a deficiency of $24,546[34] for which the mortgagee filed suit in the Circuit Court of Bolivar County, Mississippi.[35] Prior to filing this claim, however, the mortgagee had sold the property to an apparently innocent purchaser for $26,000; this sale occurred within fifteen months of the trustee's sale.[36] Upon examination of these facts, the Mississippi Supreme Court found the foreclosure sale price wholly inadequate,[37] noted recoupment to be an appropriate remedy, and affirmed the circuit court's judgment against the mortgagor for $3,546.[38] Because the mortgagor entered a plea in recoupment, the court did not have to consider the availability of judicial invalidation of a trustee's sale solely for inadequacy of bid price in a situation in which the rights of intervening good faith purchasers would be affected.[39] Although the court again[40] did not squarely address the de-

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further than its effectual diminution of the plaintiff's damages award. Under recoupment, the defendant could not receive an affirmative pecuniary judgment against the plaintiff if the jury determined the defendant's damages were greater than those of the plaintiff. Further, the defendant's right to assert recoupment had to arise out of the same contractual relationship from which the plaintiff's claim arose, and it almost always involved an unliquidated amount determinable only by the trier of fact. *See* J. POMEROY, CODE REMEDIES § 607 (W. Carrington 5th ed. 1929) (discussing recoupment and set-off); *see also* Amory Indep. Tel. Co. v. Cox, 103 Miss. 541, 547, 60 So. 641, 641 (1913) (distinguishing recoupment from set-off). *See generally* BLACK'S LAW DICTIONARY 1439-40 (rev. 4th ed. 1968) (giving illustrative cases involving pleas of recoupment).

The plea of recoupment has been rendered obsolete in Mississippi as a result of the judicial adoption of the Mississippi Rules of Civil Procedure. *See* MISS. R. CIV. P. 13 & comment (Miss. St. B. ed. 1981) (claims can now be brought as counterclaims that formerly could be asserted only by way of recoupment or set-off).

[32] 160 Miss. at 556-57, 134 So. at 183.

[33] *Id.* at 555-56, 134 So. at 183.

[34] *See id.* at 561, 134 So. at 185.

[35] *Id.* at 548, 134 So. at 181.

[36] *Id.* at 554-55, 134 So. at 182-83.

[37] *Id.* at 559, 134 So. at 184.

[38] *Id.* at 561, 134 So. at 185.

[39] *See* National Bank v. Gorenflo, 173 Miss. 646, 160 So. 911 (1935), where a plea in recoupment by an aggrieved pledgor enabled the court to grant relief without affecting the title of the once-pledged property. In that case, the pledge, stock of a closely-held corporation, had brought only $200 at foreclosure sale despite expert testimony that its value was $3,035 to $18,210. *Id.* at 651, 654, 160 So. at 912-13. The Mississippi Supreme Court found such a bid, 1% to 7% of fair value, to be unconscionably inadequate, and since the jury could reasonably have believed the value of the stock to have been greater than the secured debt of $14,500, the pledgee could properly be denied any recovery. *Id.* at 650-51, 655-57, 160 So. at 912, 914.

gree of confidence to be placed in a resale price in determining fair value,[41] the *Robinson* decision arguably indicated that the threshold of unconscionability lay between nineteen[42] and forty percent of fair value.[43]

In *Federal Credit Co. v. Boleware*,[44] the Mississippi Supreme Court was called upon to examine for inadequacy the foreclosure sale price of a mortgaged chattel purchased by the mortgagee and resold at almost four times the purchase price. The security was a truck which

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Note that under MISS. R. CIV. P. 13, *National Bank v. Gorenflo* could have yielded the same result as Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403 (Miss. 1983). Under Rule 13(a), a counterclaim may be asserted where before only recoupment was available. MISS. R. CIV. P. 13 & comment (Miss. St. B. ed. 1981). Where a defendant pleads the same facts as a counterclaim which would have previously been pled in recoupment, the defendant is entitled to an affirmative judgment against the plaintiff should the defendant's damages from the plaintiff's breach of the same contract prove greater in amount. J. POMEROY, CODE REMEDIES, § 612 (W. Carrington 5th ed. 1929); *supra* note 31 (recoupment discussed at length). Therefore, had he been able to assert a counterclaim, Gorenflo could have been awarded as damages the amount by which the fair value of the pledge exceeded the unpaid indebtedness as of the date of the foreclosure sale.

Had counterclaim been available to Robinson, the result in his case would have been unchanged since the fair value of his security was found to be greater than the bid price but less than the secured indebtedness. *See* text accompanying notes 33, 36-38.

[40] *See supra* text accompanying note 28.

[41] *See* 160 Miss. at 555, 561, 134 So. at 183-85. The court merely noted that valuation testimony had placed the value of the mortgaged land at $35,000 to $60,000 on the date of the trustee's sale. *Id.* at 555, 134 So. at 183. The court further noted that evidence had been adduced that the value had declined between that date and the resale date. *Id.* at 561, 134 So. at 185. The opinion indicated that the trial court's judgment was based on adoption of the mortgagee's resale price as fair value by the jury, but the opinion offered no discussion on the propriety of such a practice generally. *See id.* at 551, 561, 134 So. at 181, 185.

[42] It appears that the *Robinson* jury could have adopted a higher fair value amount based on the evidence adduced at trial. *See supra* note 41. However, since the judgment granting the mortgagor recoupment was based on a valuation of $26,000 in relation to a bid price of $5,000, a reasonable conclusion is that the Mississippi Supreme Court found a bid of 19% of fair market value shocking to its conscience. *See id.* at 561, 134 So. at 185, *see also supra* notes 17-18 and accompanying text.

More recently, the court has declared unconscionably inadequate a bid price of 12 ½% of established fair value. *See* Rains v. Thorp Fin. Corp., 250 Miss. 320, 326-28, 165 So. 2d 151, 153 (1964) (peremptory instruction for chattel mortgagee reversed because *inter alia* the bid price was only 12 ½% of an uncontradicted expert valuation at trial; the mortgagor had entered a plea of general issue). *But cf.* Hardin v. Grenada Bank, 182 Miss. 689, 713, 180 So. 805, 812 (1938) (substantial adverse impact of the Great Depression on land prices cited as the basis for denying relief from a bid price of 12 ½% to 20% of fair value).

[43] *See supra* notes 16-20 and accompanying text.

[44] 163 Miss. 830, 142 So. 1 (1932).

the chattel mortgagee had purchased at the public sale for $85 by outlasting another bidder. After the truck was repaired and repainted, the mortgagee resold it to an innocent purchaser for $325. The mortgagee applied only the foreclosure sale proceeds to the secured indebtedness which left a deficiency on which suit was brought.[45] In explaining its rationale for denying the mortgagor any relief, the court articulated, albeit ambiguously, its standard for bid price adequacy. Borrowing language from an early Mississippi Superior Chancery Court opinion,[46] the court said that to be shocking to the conscience, a bid price must present in relation to the fair value of the mortgaged property "an inequality so strong, gross, and manifest that it must be impossible to state it to a man of common sense without producing an exclamation of the inequality of it."[47] Regarding the issue of fair value of the mortgaged property at the time of the foreclosure sale, the court further said that the bids are "the best evidence of the market value of the thing sold."[48]

The more recent case of *Myles v. Cox*[49] presented the supreme court with still another opportunity to wrestle with establishment of fair value[50]—that amount against which bid price is compared for determination of gross inadequacy. In that case, Cauthen, the mortgagee,

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[45] *Id.* at 833-34, 142 So. at 1.

[46] *Id.* at 835-36, 142 So. at 2. The case cited was Newman v. Meek, 1 Freem. Ch. 441 (Miss. Super. Ct. Ch. 1844), discussed *supra* note 14.

[47] 163 Miss. at 835, 142 So. at 2. *See also supra* note 14.

It is interesting to note that the mortgagee's bid price of $85 was slightly more than 38% of the fair value of $220 asserted by the mortgagor, and that the bid exceeded that of an apparently innocent third party by $10. *Id.* at 834, 142 So. at 1.

[48] *Id.* at 835, 142 So. at 1. *See also supra* note 14.

[49] 217 So. 2d 31 (Miss. 1968).

[50] Establishment of a specific dollar value as fair value was particularly important to Myles, the morgagor. Unlike the mortgagor's situation in many of the previous cases, there had been no recent sale of the property for the court to look to for a fair market valuation. *See, e.g.*,, Weyburn v. Watkins, 90 Miss. 728, 733-34, 44 So. 145, 145 (1907) (land sold several times within close proximity of the foreclosure sale date, apparently for about the same price each time). Also, the bid price under the *Weyburn* standard was not grossly inadequate in relation to the fair value estimates of the mortgagee's own witnesses. *See, e.g.*, National Bank v. Gorenflo, 173 Miss. 646, 656, 160 So. 911, 914 (1935) (bid price declared unconscionable in relation to the lowest valuation offered by mortgagee); *see supra* note 21. Finally, Myles had no extrajudicial declaration of valuation by Cox to use against him. *Cf.* Bratton v. Graham, 146 Miss. 246, 259, 111 So. 353, 356 (1927) (extrajudicial statements of judgment lienee regarding fair valuation admitted as evidence against him). In order to place the bid price below the unconscionability threshold suggested by *Weyburn*, Myles had to convince the court that fair value was no less than $8,000 at the date of the foreclosure sale, since the bid was 40% of that amount. *See supra* notes 18 and 20 and accompanying text.

had called Cox, a friend and land buyer, and had informed Cox of the imminence of a foreclosure sale of realty owned by Myles as well as of the unpaid balance of the secured indebtedness. Cox appeared at the trustee's sale and purchased the land for $3,218, the balance Myles owed Cauthen.[51] Myles brought a suit in chancery court to confirm title to the land in himself.[52] Various witnesses testified as to the fair value of the land on the date of the trustee's sale, and these valuations ran from $3,400 to $16,000.[53] The chancellor determined the fair value to have been between $6,500 and $8,000. He further found the bid price not so inadequate in relation to the property's value as to shock the conscience of the court, and dismissed the complaint.[54] On appeal, the Mississippi Supreme Court ruled that the chancellor's determination of fair value of the security on the foreclosure sale date was not inconsistent with the evidence, and since it was a finding of fact, it would not be disturbed.[55] The court then found the chancellor's conclusion of bid price adequacy to be consistent with the *Weyburn* standard,[56] and affirmed his dismissal of the complaint.[57] The *Myles* decision presented an affirmative indication by the supreme court that factual determinations by a trial court in the inadequacy-of-bid-price context would not be treated differently from factual determinations generally.[58] The opinion further indicated that once fair value is determined, unconscionability of bid price in relation thereto would be strictly a legal issue determinable by the judge within the discretionary

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[51] 217 So. 2d at 33.

[52] *Id.* at 32.

[53] *Id.* at 33.

[54] *Id.*

[55] *Id.* at 34. *See also* Richardson v. Riley, 355 So. 2d 667, 668 (Miss. 1978) (chancellor's findings of fact on disputed evidence not overturned on appeal unless manifestly wrong); McNair v. Capital Elec. Power Ass'n, 324 So. 2d 234 (Miss. 1975) (same); *infra* note 59. *See generally* Allen & Taylor, *Appeals to the Mississippi Supreme Court*, 48 MISS. L.J. 505, 556-59 (1977) (standards for supreme court review of triers of fact).

[56] 217 So. 2d at 35. The chancellor found fair value to be less than the essentially requisite $8,000 discussed at *supra* note 50; he set fair value in terms of a range neither end of which was beneficial to Myles under the *Weyburn* standard. *Id.* at 34. Since the bid was slightly greater than 40% of the highest end of that range, *Weyburn* invited judgment for Cox. *See supra* note 50.

For the language employed by the *Weyburn* court to explain when a sale would be set aside for inadequacy of bid price, see *supra* text accompanying notes 16-17.

[57] 217 So. 2d at 35.

[58] *See id.* at 34; *see also, e.g.*, Wonderlick v. Gulf States Creosoting Co., 174 So. 550, 550 (Miss. 1937) (officially unreported decision) (findings of fact and application of law by a trial judge without a jury are presumed correct).

limitations defined in prior supreme court decisions.[59]

In the instant case,[60] the Mississippi Supreme Court noted the general rule to be that the courts of Mississippi will not set aside a foreclosure sale for inadequacy of sale price alone *unless* that price "is so inadequate as to shock the conscience of the court."[61] Using the unconscionability language of *Boleware*,[62] the court reasoned that since a sensible man would cry out at the inequality of allowing a mortgagee, within a few days of purchasing property at his trustee's sale, to resell at two and one-half times his bid price, the chancellor had correctly found the bid price in the instant case to be so grossly inadequate that the mortgagor should be granted some form of relief.[63] Noting that the chancellor had determined not to set the sale aside, but rather to award damages to the mortgagor, the court said it agreed in principle with the remedy fashioned below.[64] However, since the mortgagee and its immediate vendees had dealt at arms length, and since an award of damages based on the chancellor's determination of fair value would cause the mortgagee to suffer a pecuniary loss,[65] the price received by

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[59] *See* 217 So. 2d at 34-35. The *Myles* court said:

> The evidence was in conflict . . . , and though we might have found a different value had we been the trier of facts, we cannot say that the chancellor was manifestly wrong in arriving at a valuation of between $6,500 and $8,000. We accept these figures for the basis of the opinion.

Id. at 34. The court further said:

> In comparing the present consideration . . . to the fair market value of the land as found by the chancellor, we cannot say that he erred as a matter of law when his decision was within the proportions upheld by our prior decisions . . . . [W]e find no legal error therein.

Id. at 35.

[60] Central Fin. Servs., Inc. v. Spears, 425 So. 2d 403, 404 (Miss. 1983). The opinion was written by Justice Sugg; all Justices participated and concurred. *Id.* at 406.

[61] *Id.* at 404. Justice Sugg listed several Mississippi cases in which inadequacy of the foreclosure sale price was at issue and cast doubt on their precedential value. Specifically, he noted that a substantial number of those cases declaring low bids adequate had been decided during the Great Depression, implying that economic conditions had influenced the decisions. *See id.* at 404-05. *See also, e.g.*, Hardin v. Grenada Bank, 182 Miss. 689, 713, 180 So. 805, 812 (1938) (impact of the Great Depression on inadequacy of price standard specifically mentioned as ground for confirming sale at low price).

[62] 425 So. 2d at 405. *See* Federal Credit Co. v. Boleware, 163 Miss. 830, 835, 142 So. 1, 2 (1932) (statement of the "exclamation" standard). *See supra* text accompanying note 47 ("exclamation" standard quoted in full).

[63] 425 So. 2d at 405. *See supra* note 5.

[64] 425 So. 2d at 405.

[65] *Id.* The chancellor had found fair market value of the property to be $6,000, an amount $500 lower than the second resale price, but $2,000 greater than the amount the mortgagee received when it sold the property after purchasing it at the foreclosure sale.

the mortgagee from his sale of the property should be adopted as fair value in calculating damages to be awarded to the mortgagor.[66]

The Mississippi Supreme Court's opinion in *Central Financial Services, Inc. v. Spears*,[67] suggests several conclusions regarding the viability of the *Weyburn* exception.[68] The opinion, albeit ambiguously, also sheds some light on how much weight the trier of fact should attach to a resale price in determining fair value of the security.[69] Although the court has stated that it considers the bid price "best evidence" of value,[70] it likewise has placed great confidence in the price received by the mortgagee in a convenient resale to a bona fide purchaser.[71] While the tension between these competing propositions cre-

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See id. at 403-04; *supra* notes 5 and 11. The effect of the chancellor's decree would have been payment of $4,541.14 to the mortgagor by the mortgagee, resulting in a net loss to the mortgagee of more than $540. *See supra* note 12. The supreme court stated:

> CFS should not be required to suffer any pecuniary loss, which it would do under the decree of the chancellor. There is no evidence of any conspiracy between appellant and its vendees to defraud appellee by fixing the sale price below market value; rather, the sale was an arms length transaction.

425 So. 2d at 405.

[66] 425 So. 2d at 405. Note that this remedy is essentially a merger of the foreclosure sale and the resale, resulting in a damages award in the amount of the pecuniary benefits realized by the mortgagee from the resale beyond the balance owed him by the mortgagor.

[67] It appears that the case of *Central Fin. Serv., Inc. v. Spears* was decided in toto by the Mississippi Supreme Court. Not only did the supreme court make the factual determination of fair value on the ground that the chancellor's determination was manifestly erroneous, i.e. the result of an "abuse of discretion," but also it then purported to apply the *Weyburn* standard of unconscionable inadequacy of bid price itself rather than remanding the case to the chancellor for his application of that standard. 425 So. 2d at 405.

[68] *See infra* notes 73-79 and accompanying text.

[69] *See* 425 So. 2d at 404-05. After agreeing with the chancellor that the foreclosure sale price was shockingly inadequate because the mortgagee resold the property 12 days later for an amount two and one-half times greater than its bid, the court adopted the mortgagee's resale price as the figure to be used in computing the mortgagor's damages. The court rejected the chancellor's establishment of fair value at a figure substantially above the resale price, noting that the mortgagee should not suffer pecuniary loss. *Id. See supra* note 65.

[70] *See* Federal Credit Co. v. Boleware, 163 Miss. 830, 835, 142 So. 1, 2 (1932). The *Boleware* court said "The [foreclosure] sale . . . was openly and fairly conducted, and furnishes the best evidence of the market value of the thing sold." *Id. See also* Newman v. Meek, 1 Freem. Ch. 441, 458 (Miss. Super. Ct. Ch. 1844) (first statement of the concept by a Mississippi court). *See supra* note 14.

[71] *See Spears*, 425 So. 2d at 405 (mortgagee purchased property at foreclosure sale and resold 12 days later; resale price used to compute damages); Federal Land Bank v. Robinson, 160 Miss. 546, 554-61, 134 So. 180, 182-85 (1931) (mortgagee purchased security at foreclosure sale and resold slightly more than a year later; resale price used as fair

ates an indefinite standard against which to measure the efforts of a trier of fact in determining fair value, such a standard is not unworkable since it is substantially the same as the manifest error standard used by the supreme court in reviewing factual determinations generally.[72]

A close comparison of *Spears* and *Weyburn v. Watkins*[73] provides ample ground for concluding that the rule of thumb[74] as to bid price adequacy implied from *Weyburn* may no longer be reliable. In *Weyburn*, the court stated, "The testimony in this case establishes the fact that the land was sold for *about* 40 per cent. [sic] of its value. . . . [W]e would be unwilling to disturb the sale on that account."[75] In *Spears*, the court interfered with the result of the foreclosure sale where the bid price was thirty-six ("about" forty) percent of the resale price which was apparently adopted by the supreme court as fair value in calculating the mortgagor's damages.[76] Comparison of the cases also supports a conclusion that the threshold of unconscionability for foreclosure sale prices lies between thirty-six and forty percent of fair value. Even so, the court has specifically noted that this standard is indefinite,[77] making attempts to fix a point at which the court's conscience would be shocked merely speculative.[78] Unfortunately, the un-

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value); Hesdorffer v. Welsh, 127 Miss. 261, 263-64, 270, 90 So. 3, 4, 6 (1921) (mortgagee purchased security at trustee's sale and "resold" immediately; resale price noted in finding foreclosure bid inadequate); *cf.* Weyburn v. Watkins, 90 Miss. 728, 733-36, 44 So. 145, 145-46 (1907) (fair value apparently determined with reference to mortgagor's purchase price).

[72] *See* Myles v. Cox, 217 So. 2d 31, 34 (Miss. 1968) (accepting chancellor's finding of market value because not "manifestly wrong"). *See supra* note 55. For a discussion of the standards of review employed by the Mississippi Supreme Court, see Allen & Taylor, *Appeals to the Mississippi Supreme Court*, 48 MISS. L.J. 505, 556-59 (1977).

[73] 90 Miss. 728, 44 So. 145 (1907). *See supra* notes 13-20 and accompanying text.

[74] *See supra* text accompanying notes 19-20, 29, 42-43.

[75] 90 Miss. at 735, 44 So. at 146. [Emphasis added].

[76] 425 So. 2d at 405.

If the *Weyburn* rule of thumb of "about forty percent" is indeed no longer reliable, one could further conclude that the present court has raised the threshold ensuring that its location will remain an unsolved mystery. *See supra* note 61.

[77] Myles v. Cox, 217 So. 2d 31, 34 (Miss. 1968). In *Myles*, Justice Patterson said:

> Conceding that "the conscience of the court" is an indefinite standard by which a determination can be made to ascertain the precise point of which an inadequate consideration becomes so grossly inadequate as to require a trustee's sale to be set aside and conceding that we know of no definitive standard to the situation, we turn, as we must, to our prior decisions for guidance . . . .

Id.

[78] The uncertainty of whether a specific bid price may be inadequate is compounded by the fact that the fair market value against which bids are measured is apparently a

certainty of this standard may discourage mortgagors with legitimate claims of inadequate bid price from asserting their claims.[79]

In *Spears*, the supreme court did not set aside the forclosure sale and subsequent resales, although its decision put the mortgagors in the same economic position as if they had sold the property willingly to the mortgagee's vendee.[80] No Mississippi case has been found in which a foreclosure sale was actually set aside and title confirmed in the mortgagor unless the ousted purchaser had some actual or constructive knowledge at the time of his purchase of inequitable circumstances surrounding the foreclosure sale so as to put him on notice that his title might be defective. Even in the few Mississippi cases in which title was confirmed in the mortgagor seemingly for inadequacy of bid price alone, such knowledge on the part of the ousted purchaser was proven.[81] Arguably then, Mississippi courts will not set aside a foreclosure sale or a subsequent resale merely for inadequacy of bid price, however shocking it may be, unless the party to be ousted participated in or should have been aware of inequitable conduct concerning the public sale.[82]

Spears is not the first Mississippi case in which a mortgagor was granted relief short of setting aside the foreclosure sale when the property had come into the hands of a purchaser unaware of the circum-

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question for the trier of fact. *See* Myles v. Cox, 217 So. 2d 31, 34 (Miss. 1968); *supra* note 59.

[79] Does this mean that the "just, speedy, and inexpensive" administration of justice requires innumerable mortgagors to suffer real, undetected injury in silence? *See* Bates v. State Bar, 433 U.S. 350, 375-76 (1977) (same argument unavailing in support of legal advertising ban). *Cf.* Miss. R. Civ. P. 1 (Miss. St. B. ed. 1981) (judicial procedural changes justified as promoting "just, speedy, and inexpensive" administration of justice).

[80] *See* 425 So. 2d at 405. *Compare supra* text accompanying note 66 *with* chart *supra* note 12.

[81] *See* Blacketor v. Cartee, 172 Miss. 889, 896, 900, 161 So. 696, 698-99 (1935) (mortgagee purchased at trustee's sale); Bowers v. Fields, 148 So. 358, 358 (1933) (mortgagee's wife purchased); Hesdorffer v. Welsh, 127 Miss. 261, 262-64, 90 So. 3, 3-4 (1921) (mortgagee purchased and sold immediately to a vendee who had discovered a defect in the mortgagee's title from earlier attempted foreclosure on that property); *cf.* Baldwin v. Anderson, 103 Miss. 462, 467-68, 60 So. 578, 580 (1913) (warranty deed set aside on grounds that grantee was on inquiry notice since deed to grantor recited full but unconscionably inadequate consideration).

[82] *See also* Dingus, *Mortgages—Redemption After Foreclosure Sale in Missouri*, 25 Mo. L. Rev. 261, 262-66 (1960) (author concluding the same of Missouri law). *See generally* G. Osborne, G. Nelson, & D. Whitman, Real Estate Finance Law § 7.21 (1979) (authors concluding the same to be the general rule even in jurisdictions giving lip service to a *Weyburn* type exception).

stances of the trustee's sale.[83] *Federal Land Bank v. Robinson* held the common law remedy of recoupment to be appropriate in such circumstances.[84] Since recoupment was, in effect, a restricted form of damages, and since an unconscionably inadequate foreclosure sale price served as the basis for relief in both *Robinson* and *Spears*, a reasonable conclusion is that these cases are authority for the existence under Mississippi law of a mortgagor's right to recover damages—but damages only—from his mortgagee when the mortgagee, without attendant inequities, purchases the security at a trustee's sale for an unconscionably low price and resells it to an innocent third party.[85] Such a remedy[86] not only preserves the integrity of the prior cases, it also ensures the availability of credit by not upsetting the protection traditionally given to bona fide purchasers.[87]

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[83] *See supra* notes 30-32 and 39 and accompanying text.

[84] *See supra* notes 30-39 and accompanying text.

[85] No case was found in which a mortgagor relying on inadequacy of bid price alone had filed an affirmative claim for damages, though some mortgagors who had been sued for deficiency judgments, after foreclosure, had entered pleas of recoupment. *See supra* note 19 (discussion of cases in *Weyburn* line).

[86] This concept is apparently not unique to Mississippi law. *Cf.* Chemical Bank & Trust Co. v. Adam Schumann Assocs., 150 Misc. 221, 268 N.Y.S. 674, 677 (N.Y. Sup. Ct. 1934) (court reduced deficiency by amount of mortgagee's unconscionable windfall on immediate resale of the property). Unfortunately, the concept is also not universally accepted. For example, the courts of Texas have turned a deaf ear to complaints of unconscionability of foreclosure sale price unless there is *some* proof of attendant inequitable conduct by the purchaser or non-compliance with the foreclosure statute. In Biddle v. National Old Line Ins. Co., 513 S.W.2d 135 (Tex. Civ. App. 1974), the doctrine as currently enforced was expressed by the court:

> We have carefully considered the entire statement of facts and without detailing the testimony, find therein *no* evidence of any chilling of bidding or other irregularity which caused or contributed to cause the property to be sold at a *grossly inadequate price*. Therefore, we do not reach the question as to whether the sale was grossly inadequate.

513 S.W.2d at 138 (emphasis added). *See also* Purnell v. Follett, 555 S.W.2d 761, 763 (Tex. Civ. App. 1977) (relief denied to a mortgagor aggrieved over a foreclosure sale price of *three* percent of estimated fair value since the sale was conducted in compliance with the statute and without proof of inequitable conduct); Tarrant Sav. Ass'n v. Lucky Homes, Inc., 390 S.W.2d 473, 475 (Tex. 1965) (leading case on the proposition that "mere inadequacy of consideration alone does not render a foreclosure sale void if the sale was legally and fairly made").

[87] Of course, the power of sale foreclosure is intended to give lenders of purchase money reasonable assurance of a return of their initial investment at the end of the agreed term plus enough additional cash (or cash equivalent) to compensate the lenders for putting their capital at risk during the term with the particular borrower. However, if a purchaser at a foreclosure sale (assuming the mortgagee did not purchase from the trustee) could be ousted of his title for mere inadequacy of the foreclosure sale price

If Mississippi courts indeed will not actually *set aside* a foreclosure sale when the rights of bona fide purchasers are implicated but instead will award damages to the legitimately aggrieved mortgagor, the Mississippi Supreme Court missed a fine opportunity to clarify the mortgage law of Mississippi by saying so in *Central Financial Services, Inc. v. Spears*. Further, if fair value of the security on the date of the foreclosure sale is indeed a factual determination reversible only for manifest error, and if unconscionable inadequacy is determined as a matter of law by the judge based on his comparison of that fair valuation to the standard adopted in *Weyburn* and its progeny, the facts of *Spears* were ideally suited to supporting an affirmative statement to that effect.[88] Arguably, such a statement by the court would have created no new rights or remedies, but it would have made more understandable the rights and remedies existing under Mississippi law at least since *Robinson* was decided.[89] By expressly recognizing a right to damages in a mortgagor who establishes a shockingly inadequate bid price but proves no attendant inequities involving the subsequent purchaser of the once-mortgaged property, the court would be holding intact the traditional protection given bona fide purchasers thus ensuring ready availability of credit, and it would be distributing the economic burden of unfortunate circumstances among those who equitably should bear it.

Jimmy Ried Sledge, Jr.

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despite that purchaser's actual, *but unproven*, good faith, bidding could be chilled. Likewise, if the mortgagee had purchased from the trustee, resale might be more difficult. *See generally* Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 851-55 (1980). It does not seem likely that the remedy implied by *Robinson* and *Spears* will deter low bids by mortgagees. If the resale profit is declared unconscionable, the mortgagee loses only his resale profit; the profit under the loan contract itself is unaffected. *See supra* notes 65-66 and accompanying text.

[88] *Compare supra* text accompanying notes 63-66 *with supra* note 67.

[89] *See supra* note 39.

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